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STATE OF MONTANA

DEPARTMENT OF LABOR AND INDUSTRY
EMPLOYMENT SECURITY DIVISION

REPORT ON THE EFFECTIVENESS OF FINANCING AND SELECTED ELIGIBILITY, JOB SEARCH AND BENEFIT PAYMENT OPERATIONS OF THE UNEMPLOYMENT INSURANCE PROGRAM

December, 1976

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EMPLOYMENT SECURITY DIVISION

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December, 1976

MONTANA LEGISLATIVE AUDIT COMMITTEE
AND OFFICE OF THE LEGISLATIVE AUDITOR

The Legislative Audit Committee is a joint, bipartisan standing committee of the Montana Legislature. The committee is composed of eight members (listed below) appointed by the Senate Committee on Committees with the approval of the Senate and the Speaker of the House.

The committee and the Office of the Legislative Auditor were established for the purpose expressed in Section 79-2301, R.C.M. 1947:

> "Because the legislative assembly is responsible for authorizing the expenditure of public moneys, designating the sources from which moneys may be collected, shaping the administration to perform the work of state government, and is held finally accountable for fiscal policy, the legislative assembly should also be responsible for the audit of fiscal accounts and records so that it may be assured that its directives have been faithfully carried out. It is the intent of this act that each agency of state government be audited for the purpose of furnishing the legislative assembly with factual information vital to the discharge of its legislative duties."

To accomplish the foregoing purpose, the Office of the Legislative Auditor is empowered by law to conduct audits of state agencies to ascertain, among other things, whether state agencies are:

> "... carrying out only those activities or programs authorized by the legislative assembly and is conducting them efficiently and effectively." (Emphasis supplied)

The law also authorizes the Office of the Legislative Auditor to make recommendations for improvement of state government programs and operations. Recommendations for improvement of administrative activities are addressed to the agencies responsible for the activities. Recommendations for legislative changes are left to the discretion of the Legislature.

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December 21, 1976

The Legislative Audit Committee
of the Montana State Legislature:

Herein transmitted is our program/performance audit of the financing and selected eligibility, job search and benefit payment operations of the unemployment insurance program administered by the Employment Security Division of the Department of Labor and Industry.

The purpose and scope of the audit are explained in Chapter I (page 1) of the report and in the summary which begins on page S-1.

This report contains major recommendations for administrative and statutory changes in the unemployment insurance program in Montana.

Since the 1977 Legislature may want to consider some of these recommendations, we were unable to allow the Employment Security Division the time they believed necessary to prepare a detailed formal reply to the report. Nevertheless, we discussed the contents of the report with the administrator and his staff and have included a general reply from the administrator in the report (page 197). Because of the time limitation, we were also unable to review the contents of the report with the 15-member Employment Security Division Advisory Council. However, copies of the report have been sent to each member.

We wish to express our appreciation to the administrator and his staff for their outstanding cooperation and assistance.

Respectfully submitted,

Morris L. Brusett

Morris L. Brusett, C.P.A.
Legislative Auditor

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OFFICE OF THE LEGISLATIVE AUDITOR

EFFECTIVENESS OF FINANCING AND SELECTED ELIGIBILITY, JOB SEARCH AND BENEFIT PAYMENT OPERATIONS OF THE UNEMPLOYMENT INSURANCE PROGRAM

SUMMARY

This report is the result of our program audit of certain operations of the Employment Security Division of the State Department of Labor and Industry. This audit supplements our earlier financial/compliance audit of the Employment Security Division. The results of that audit (Report on Examination of Financial Statements) were published in a report issued in May 1976.

CHAPTER I. INTRODUCTION

This report is presented in five chapters: Chapter I (page 1) presents an introduction and summarizes the scope and general direction of the audit; Chapter II (page 4) presents background of unemployment insurance in the U.S. and in Montana; Chapter III (page 24) is a detailed commentary on the tax system that finances the unemployment insurance program; Chapter IV (page 85) is an evaluation of unemployment insurance benefits and discusses areas where measures should be taken to strengthen and improve the effectiveness of the unemployment insurance program; and Chapter V (page 165) discusses eligibility for unemployment benefits and the effectiveness of the job search process.

The audit had three objectives:

(1) To determine the effectiveness of the systems and procedures which underlie the financing of the unemployment insurance program in Montana;

(2) To determine whether the payment of unemployment insurance benefits in certain circumstances meets the stated purpose and goals of the unemployment insurance program; and

(3) To assess the effect of more rigorous job search requirements on the payment and duration of unemployment insurance benefits (page 2).

The audit focused on the unemployment insurance functions of the Employment Security Division of the State Department of Labor and Industry (page 2). The audit did not include an evaluation of the claim process, the overall eligibility determination process, or the fraud detection program. The audit also did not encompass the internal financial/compliance operations of the Employment Security Division since those matters were addressed in our financial/compliance audit and resultant audit report published in May 1976 (page 3).

CHAPTER II. BACKGROUND ON UNEMPLOYMENT INSURANCE

Unemployment insurance insures workers against the risk of personal loss (wage loss) due to unemployment. The program is "social" insurance in contrast to private insurance in that it involves the general population and is based upon factors which can be changed unilaterally by government. One of the major characteristics of unemployment insurance (UI) as an insurance program is that it is based upon "rights" rather than "needs." This is an important distinction and is what makes UI different from public assistance or welfare. This characteristic of the UI program should be kept in mind when considering this report and the nature of UI insurance in general (page 4).

The unemployment insurance program in Montana is part of a nationwide program undertaken as a joint venture by each of the 50 states, the District of Columbia and Puerto Rico, with the federal government. Almost every aspect of the UI program in Montana and the other states is in some way related to the federal government either as a direct or an indirect result of federal legislation and federal guidelines (page 5).

The first actual federal UI bill was introduced in the Congress in 1928 but no action was taken. In August 1935 a federal UI program was enacted as a part of the United States Social Security Act of 1935. After an in-depth study of social insurance, the program included in this landmark legislation unemployment insurance, social security (old age assistance), and public assistance (welfare)--were all intended to provide for individuals when economic conditions beyond their control limit their ability to provide for themselves. They were controversial programs generating intense opposition when they were enacted and for years after (page 7).

The Montana Legislature enacted Montana's UI program in 1937. The bill was approved on March 16, 1937, and took effect immediately. The purpose of the program was explicitly described by the original act and has remained the same up to the present (page 9).

The law created the Unemployment Compensation Commission to administer the UI program and organized two divisions: the state Employment Service Division and the Unemployment Compensation Division. The Employment Service Division was established for the purposes of: (1) providing free public employment offices throughout the state, and (2) assuming eventual control and operation of the U.S. National Reemployment Service functions in Montana (page 10). In July 1939 Montana began paying unemployment compensation benefits.

Because of World War II, the employment service operations for all states were transferred for a temporary-emergency period back to the federal government in 1941. However, complete separation of the agency operations never really occurred and the paper separation continued for nearly five years--until November 1946--when the federal government transferred the employment service operations back to the state (page 11).

The executive reorganization process in 1971 abolished the commission as a separate agency and created (1) a new state department--the Department of Labor and Industry, and (2) two new units within the department dealing with labor--the Board of Labor Appeals and the Employment Security Division (page 11). One of the more substantial changes of the executive reorganization was the abolishment of the prior three-member commission and the provision for appointment of an administrator of the division by the commissioner of the department (page 12).

As a general rule, the operations of the division in terms of finances fall into two general categories, administrative operations and UI benefits. The administrative operations are financed by federal grants. Some of the money for these federal grants comes from federal UI taxes on employers. In contrast, the UI benefits in Montana are almost all financed directly by the Ul tax on employers in Montana. The exceptions are special federal programs which provide for extended or supplemental UI benefits (page 13).

Generally, all employers in Montana with a total annual payroll of $500 or more are required by law to participate in the UI program including state and local governments and nonprofit organizations. The law also specifies that 11 categories of employment are excluded from the state UI program (page 15).

In Montana and other states there are various programs under which UI benefits are paid. There is the basic state UI program which is 100 percent state financed and seven other UI programs financed in part or in whole by the federal government (page 16). Based on these programs, it is possible for an unemployed worker to draw UI benefits for up to 65 consecutive weeks if all UI programs are operating (page 18).

Historically, Montana's unemployment rate has generally exceeded the national average. The 1975 recession hit industrialized states harder than agricultural states. Therefore, contrary to historical trends, the national unemployment rate for 1975 surpassed Montana's (page 21). Due to the severity of the recession the Montana UI program has undergone the most extreme test it has ever faced. This has also happened in other states. Inasmuch as the crisis has been nationwide, the Congress recently enacted legislation (H.R. 10210, the Unemployment Compensation Amendments of 1976) which addresses some of the topics discussed in the report (page 22).

We have considered the effect of the new federal legislation in formulating our conclusions and recommendations in the report. Montana will have to change its UI system to meet the federal requirements or risk losing the federal tax credit for Montana employers (page 23).

CHAPTER III. THE TAX SYSTEM THAT FINANCES UNEMPLOYMENT INSURANCE

The unemployment insurance program in the United States basically operates on the basis of money provided by the taxation of employers. In all except three states--Alabama, Alaska and New Jersey--employers pay the taxes which finance the state unemployment insurance benefits and the federal and state administrative costs of the unemployment insurance program.

The money collected by Montana under the UI tax is deposited in the Montana unemployment trust fund account in the U.S. Treasury (pages 28, 29). Since inception of the fund to June 30, 1975, contributions by Montana employers total $192,545,000. Interest earned totals $26,577,000 (page 30).

The amount of the state UI trust fund depends primarily upon two factors: (1) the revenue to the trust fund, and (2) the UI benefits paid out of the fund. The history of Montana's UI trust fund balance shows a mixed trend from $4.7 million in 1937 to a high of $46.2 million in 1956 to a projected deficit of $1.1 million at December 31, 1976 (page 31).

In April 1976 the Montana UI trust fund became insolvent--there were insufficient reserves and revenue to pay current UI benefits. Consequently, Montana began borrowing money from the Federal Unemployment Account in the U.S. Treasury. In March 1976 Montana's trust fund had been advanced $1.4 million and official predictions estimate this loan will be sufficient only through December 31, 1976. The division has requested an additional loan of $2,283,000 to sustain the fund through January 31, 1977 (page 32).

Montana was not alone in having a bankrupt UI trust fund. In fact, 21 states (including Montana) have borrowed $3.1 billion from the Federal Unemployment Account. The advances to states from the federal UI account are interest-free but repayment is required (page 33).

Employers in Montana face a future period of heavy UI taxation which is necessary to (1) repay the federal advance; (2) pay current UI benefits; and (3) restore the solvency of Montana's UI trust fund. The important aspect of these problems is that all of these things have to

be done simultaneously. To accomplish this, ESD needs to resolve problems in five separate but interrelated areas by determining (page 34):

(1) what the minimum UI trust fund level should be;

(2) what the rate of recovery should be for the UI trust fund;

(3) whether the UI tax rate and/or tax base should be changed;

(4) whether experience rating is working properly; and

(5) whether actuarial services are warranted.

One of the first problems that needs to be addressed is the minimum trust fund level. There are several ways to measure the adequacy and solvency of the UI trust funds. One of the measures most widely accepted is the high cost multiple reserve. This measure applied to Montana trust fund data indicates that the current insolvency would have been averted or at least delayed, possibly into the period of economic recovery (page 37). While the criteria shows that the trend of Montana's trust fund balance was the opposite of what it should have been, the criteria itself has deficiencies which inhibit the responsiveness of the UI trust fund. Since the primary objective of the trust fund is to provide a reserve for lean years--recessionary years are lean years--the criteria which fixes the fund balance should always in some way incorporate the potential losses (benefits) during a recession (page 38).

Montana has not determined what trust fund balance is necessary to accomplish the objectives of the UI program. The fund balance in the past has basically been self-determined rather than having been predetermined. In order to have a meaningful insurance function which accomplishes what an insurance function is supposed to--establish a reserve to meet potential losses--Montana needs to determine what minimum trust fund balance is necessary for the short and long range (page 41).

RECOMMENDATION (page 42)

We recommend that the division institute a methodical and actuarily-sound means of forecasting the minimum trust fund balance.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

Determining what the trust fund balances should be is only the first step in resolving the problems facing the UI program in Montana. The division must also determine what the rate of recovery should be to replenish the trust fund (page 42).

Faced with borrowing and the current level of benefit costs, as well as the current level of UI taxes, the division predicts that it could be several years before the trust fund balance is adequate to cover potential benefit costs and the federal debt (page 42).

Optimum recovery considering current economic conditions requires that the division establish a step-by-step process with specific interim targets or goals set in terms of the amount of the UI tax revenue which needs to be collected to (1) pay current benefit costs, and (2) generate a contribution towards restoration of the trust fund (page 43).

RECOMMENDATION (page 44)

We recommend that the division formulate a plan of specific interim targets and goals and a revised UI tax structure including any appropriate legislation to provide for a gradual and reasonable restoration of the trust fund.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

The UI tax in Montana and most other states is an employer tax based on the employer's payroll. The amount of UI tax collected depends upon two factors--the tax rate and the wage base.

Both the UI tax rate and wage base in Montana are specifically prescribed by state law (page 44). The UI tax rate ranges from 0.5 percent to 3.1 percent depending upon employer employment history and the status or level of the trust fund. The UI wage base ranges from $4,200 to $4,800, also depending upon the status of the trust fund or the federal wage base, whichever is higher. Montana's wage base went to $4,800 on January 1, 1976, and all covered employers will pay the maximum tax of 3.1 percent on January 1, 1977. The federal wage base was recently increased (by H.R. 10210--the Federal Unemployment Compensation Amendments of 1976) from $4,200 to $6,000. This increase becomes effective on January 1, 1978. Consequently, Montana's wage base will also increase to $6,000 on January 1, 1978, and the tax rate in Montana will thereafter be levied against the first $6,000 paid to each employee by covered employers in the state (page 45).

Essentially, the level of UI taxes involves two or three alternatives. UI taxes on employers can be raised and additional UI revenue collected by: (1) raising the wage base; (2) raising the tax rate; or (3) raising both the wage base and the tax rate. There are advantages and disadvantages with each alternative (page 45).

There are basically two problems involved with the UI wage base, both nationally and in Montana: the erosion of the wage base and the relationship of the wage base to benefits (page 45).

Erosion pertains to the fact that wherein once virtually all of the wages paid by covered employers were subject to the UI tax, now only about 50 percent of the wages are subject to the UI tax (page 46). In 1975 the annual average wage in covered employment in Montana was $8,422.96, while the wage base is $4,800 or about 57 percent (page 48). A large number of states (16) currently have wage bases in excess of Montana's current level of $4,800 (page 50).

In addition to having a wage base in excess of Montana's, six of the preceding states use some form of "escalating wage base" which changes as the average covered wage changes (page 50). Such a wage base is more responsive and flexible than a fixed wage base such as is used in Montana (page 51).

Just as the UI wage base has not kept pace with wages, it has also not kept pace with UI benefits. UI benefits in Montana are escalating--based upon 60 percent of the average annual wage. In Montana, as wages go up, benefits also go up, yet the wage base--which finances the benefits--remains the same (page 52). The laws governing Montana's wage base need to be amended to provide for a flexible or escalating wage base.

RECOMMENDATION (page 55)

We recommend that legislation be enacted to establish a flexible wage base as a percentage of the average annual wage in covered employment.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

Another problem that needs to be addressed is the tax rate. Initially the tax rate in Montana was 2.7 percent of the total annual payroll of covered employers (page 56). Currently Montana UI trust fund is supported by a tax on employers between 0.5 percent to 3.1 percent depending on the experience rating. The lower tax rates gradually increase as the trust fund balance decreases, i.e., a trust fund balance of less than one percent of total annual wages will eliminate the effect of experience rating and charge all employers the maximum tax rate of 3.1 percent (page 57).

Since the Montana trust fund had a balance below one percent of total annual covered wages in Montana for fiscal year 1976, virtually all employers (the exceptions being government and nonprofit employers) will begin paying the maximum rate, 3.1 percent, on January 1, 1977. Restoration of the trust fund to enable experience rating under the current system will require several years (page 57).

There are a substantial number of states which have maximum tax rates higher than Montana's. By having such rates, these states are better able to distribute the tax burden to those employers who are associated with high unemployment. There is substantial evidence to indicate that the UI tax rate schedule has major flaws (page 58). Inasmuch as the amount of UI tax revenue collected depends both upon the wage base and the tax rate, revision of one must consider the other.

RECOMMENDATION (page 61)

We recommend that legislation be enacted to expand the current tax rate schedule to raise the upper limit tax rate to more closely approximate the experience of employers whose benefit costs exceed taxes paid.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

Inasmuch as unemployment insurance is an insurance program, various features of insurance functions have been incorporated into the program. Among these are the building of reserves, sharing of risk (a certain degree of cross-subsidization) and experience rating (page 62).

In spite of certain significant differences, all of the systems in use by the states are now categorized into four distinct types: reserve-ratio, benefit-ratio, benefit-wage-ratio, and payroll-decline (page 63).

Of the four basic methods of experience rating used by the states our comparison focused primarily on two systems--payroll decline, the present system used in Montana, and reserve-ratio, the system used by most other states (page 66).

Employers under a reserve-ratio system of experience rating know they will pay for all chargeable benefits against their firm. This knowledge provides these employers with a positive incentive not to create unemployment. In contrast, under the payroll decline system employers' UI taxes increase when their payrolls fluctuate or decline. Thus they may be causing unemployment, but they could also be replacing

retired personnel with young workers at a lower payrate, thereby decreasing payrolls. The opposite could also occur: general increases in salary for inflation could offset actual layoffs. The reserve-ratio system definitely provides more incentives to employers to decrease unemployment (page 68).

The payroll-decline system of experience rating reacts quickly to changes in business cycles. In contrast, the reserve-ratio system has a slow reaction to business cycles, thereby resulting in a general countercyclical effect which is good (page 68). Stabilization is accomplished by reserve-ratio, in incentives to the firm and overall timing in conjunction with business cycles. Payroll decline offers smaller incentives to the firm to stabilize unemployment and its timing is procyclical. Reserve-ratio is better in reaching this goal (page 69).

Another goal of experience rating is cost allocation, the proper charging of taxes to firms from which unemployment originates (page 69). Again, the reserve-ratio system is better than the payroll decline system in use in Montana (page 70).

Most states using the reserve-ratio system also use proportional charging of base period employers. Problems associated with such charging arise from ineffectively charged or non-charged benefits. Montana essentially abandoned a direct chargeback system because of gradually exempting more and more employers from charges for employees who quit, were fired for cause, etc. (page 70).

Prior to 1975, Montana had a hybrid system of experience rating which was based on one-third employer years of operation, one-third payroll decline and one-third reserve ratio. By 1973 almost half of benefits were non-charged or ineffectively charged. By 1975 over 50

percent of the UI benefits paid were non-charged; i.e., not correlated to any employer (page 70). Payroll-decline only estimates the amount of ex-employees and does not attempt to measure the amount of benefits collected (page 71). By design the payroll decline method does not charge back benefits to employers. Consequently, the reserve-ratio system has an advantage with respect to the second goal of experience rating--cost allocation (page 71). Finally, the reserve ratio system results in greater employer interest and participation in the UI program, especially policing the system to insure that excess or illegitimate benefits are not paid (page 71).

Under the reserve-ratio system employers have a monetary interest and incentive to police the system, whereas under the payroll decline system there is a decided lack of policing by employers--employer appeals in the payroll decline states are substantially less than the national average (page 71). The payroll decline system of experience rating has been described as being the farthest away from genuine experience rating (page 75). Montana's system of experience rating is the most ineffective and least desirable of the various systems available (page 76).

RECOMMENDATION (page 78)

We recommend that legislation be enacted authorizing the establishment of a reserve-ratio method of employer experience rating.

The division expressed the belief that the payroll-decline system of experience rating used in the Montana UI program will work satisfactorily if it is given an opportunity to do so (page 197).

* * *

In most insurance operations it is generally recognized that actuarial analysis of the factors involved is necessary to successfully operate over the long run (page 79). An actuarial analysis addresses issues which are crucial to the proper operation of an insurance activity such as the establishment of rates and reserves, prediction of factors which might affect rates and reserves, the operation of the insurance activity, and the effect of anticipated and unanticipated trends and events (page 79). Our report discusses many interrelated aspects of UI taxation and benefit payments which all affect the soundness of the Montana UI trust fund as an insurance program. Formal actuarial services should be a fundamental part of the UI operation. This has not been accomplished for the Montana UI operation although some states have taken this step to evaluate their funds (page 80).

In order to evaluate the need for such actuarial services in Montana, we engaged an actuarial consultant. The results of the brief actuarial study are shown as Appendix B (page 187) of this report which substantiate the conclusions and recommendations made in the report (page 83).

RECOMMENDATION (page 83)

We recommend that the division engage an independent actuarial firm specializing in unemployment insurance to:

1. *Assist in the determination of alternatives and the formulation of proposals for the:*
   a. *Establishment of an appropriate trust fund balance;*
   b. *Reasonable and gradual restoration of the trust fund;*
   c. *Establishment of a variable wage base;*

d. Revision and expansion of the tax rate schedule; and

e. Revision of the experience rating system.

2. *Conduct periodic independent actuarial reviews of the UI trust fund.*

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

CHAPTER IV. PAYMENT OF BENEFITS TO UNEMPLOYED CLAIMANTS

The payment of UI benefits to eligible unemployed workers is the culmination of the UI tax and eligibility determination process. The entire process exists, in essence, to do one primary thing--provide money to eligible unemployed workers until such time that they are reemployed (page 85). Our principal reason for reviewing the UI benefit payment and eligibility process is to determine whether the statutory purpose of the UI program is being carried out--protection of unemployed workers against economic insecurity caused by loss of jobs through no fault of their own. This basic premise was enacted as part of the original UI law and has not been modified since enactment in 1937. This purpose is somewhat in conflict with other sections of the law which provide for payment of benefits to persons unemployed through their own actions, such as workers unemployed due to voluntary quits, misconduct discharges, labor disputes and seasonal and unemployed workers whose economic insecurity may be nonexistent because of supplemental income from sources such as retirement income or part-time earnings (page 85).

In all states, an unemployed worker's UI benefit rights depend upon his work experience in a past period of time, the base period (page 87). The basic requirements for benefit eligibility are that a totally unemployed worker must register for work at the employment office, continue to report as required by regulation, make claims for benefits, and be able, available, and seeking work (page 87).

The UI benefits in Montana currently range from a minimum of $12 per week to an average of $66.05 per week and a maximum of $97 per week Page 88).

It is important to note that UI benefits are not subject to income taxes. Consequently a UI benefit of, say, $97 per week is free and clear in contrast to wages (page 89).

Various studies of the UI program have shown that lenient or strict administration of the UI program has direct effects upon several aspects of unemployment. While a very stringent program will reduce the dollar outlay for UI benefits, it could prevent some who need and deserve benefits from getting them. Some studies indicate that the lenient granting of UI benefits to workers who voluntarily left their jobs due to choice or avoidable conduct has a definite tendency to extend the duration of unemployment as the amount of UI benefits available increases. In other words, the more an unemployed worker can obtain through UI, the less tendency and motivation there is to find a job (page 92).

The illustration on page 94 shows the number of claimants and benefit amounts paid to claimants who were considered in our examination of the UI program.

Montana pays UI benefits to unemployed workers who have voluntarily quit their jobs after a short disqualification and postponement period--

two to five weeks as determined by the division (page 94). This disqualification has not changed substantially since enactment of the law in 1937 except that the postponement feature became effective in 1963 (page 95).

All states have disqualification provisions for voluntary quits. The types of disqualifications are (page 96):

--Fixed number of weeks--14 states

--Variable number of weeks--13 states (including Montana)

--Duration of unemployment--37 states

In addition, a number of states reduce the claimant's eligibility for UI benefits by a specified number of weeks, usually equal to the disqualification period (page 96).

Generally, a strong trend exists among the states toward more stringent disqualification for workers who voluntarily quit their jobs (page 97). Generally those workers who voluntarily quit their jobs during the 18-month test period covered during our examination had an average duration of unemployment longer than did claimants who were terminated by layoff--24.02 weeks versus 14.16 weeks.

Workers who voluntarily quit their jobs were more than twice as likely to exhaust their UI benefits than the workers who were routinely unemployed. The most logical explanation for this significant difference is that workers who voluntarily quit are not as active in seeking reemployment as the involuntarily unemployed workers (page 104).

The granting of UI benefits to workers who voluntarily quit their jobs whether for a short duration or for a lengthy duration is allowed by Montana statute, although such a practice appears to conflict with

the basic intent of the UI program: meeting the needs of those workers who are involuntarily unemployed through no fault of their own (page 107).

RECOMMENDATION (page 108)

We recommend that legislation be enacted to amend Section 87-106(a), R.C.M. 1947, to provide for disqualification for the duration of unemployment caused by voluntarily leaving employment without good cause and reemployment requirements to establish attachment to the labor market.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

Montana's UI law also provides that claimants who have been fired from their jobs for misconduct can receive unemployment insurance after a disqualifying and postponement period--two to nine weeks as determined by the division. The worker who becomes unemployed by an act of misconduct is guilty of willful neglect of his employer's interests. By his own volition, the claimant is out of work and out of a job (page 109). The Montana statute appears to have been based on the philosophy that an unemployed worker is no longer responsible for his unemployment after a certain period of time depending on labor market conditions (page 109). However, the trend in the last 20 years has been to tighten eligibility requirements and to make disqualification penalties more severe (page 110). A comparison of the Montana state prescribing disqualification with those of the other 50 states shows that as of January 1,

1975, 34 states are more stringent than Montana (page 110). The types of disqualifications used by the various states are as follows (page 110):

--Variable weeks--22 states (including Montana)

--Fixed weeks--16 states

--Duration of unemployment--26 states

The trend among the states has been to disqualify workers discharged for misconduct for the duration of their unemployment period and to require that the unemployed worker return to work to earn or reestablish qualifying wages, thus showing sincere attachment to the labor market (page 111). It is significant to note that the more severe disqualification was legislated in six states during 1975 (page 112).

The average duration of unemployment for misconduct discharges was longer than those claimants who were laid off--24.76 weeks versus 14.16 weeks (page 114). Most of the misconduct discharges occurred because the claimant did not want to work--21 percent for not reporting for work and 23 percent for "absence from work" (page 115).

It does not seem just for a worker to be allowed UI benefits which are financed by his employer when the worker's unemployment is the direct result of his own misconduct. The Montana law should be strengthened to preclude this from happening (page 119).

RECOMMENDATION (page 120)

We recommend that legislation be enacted to amend Section 87-106(b), R.C.M. 1947, to provide a disqualification for the duration of unemployment caused by misconduct discharge and reemployment requirements to establish attachment to the labor market.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

Seasonal unemployment also has a large effect upon the UI program. Most of Montana's employment can be generally characterized as seasonal. This is because of the type of industries in Montana, the weather conditions, and because of the granting of benefits to seasonal employees. Montana law does not provide for disqualification of seasonal claimants except for those employed in the educational system. For this reason much of Montana's UI benefit payments are for predictable seasonal layoffs as contrasted to cyclical economic layoffs. Data available at the division shows that 86 percent of the Montana industry has definite predictable seasonality (page 120).

A comparison of national seasonality indices with Montana seasonality indices by industry shows that Montana is well above the national average (page 122).

When the UI program began many states were concerned that seasonal industries would draw heavily and cause possible insolvency of the system. However, the states have gradually repealed restrictions against seasonal industries and today only 13 states have special provisions in effect. The general intent of all of these provisions is to restrict the payment of UI benefits to workers who work only in a seasonal industry for their livelihood (page 126). Other states which do not specifically address seasonal employment provide incidental exclusions through eligibility determinations of qualifying wage levels and workweek requirements.

There has been a slow trend toward adoption of minimum work week requirements in preference to seasonal restrictions (page 127).

A 20-week work requirement for basic eligibility has been recommended in other studies (page 131). Such an eligibility requirement for Montana would eliminate some of the seasonal employees from the UI program--especially those employed in the tourist industry (page 132).

RECOMMENDATION (page 133)

We recommend that legislation be enacted to amend Section 87-103(c), R.C.M. 1947, to incorporate a requirement for a qualifying period of a minimum number of weeks of work.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

The UI laws in Montana also allow an unemployed worker to work a certain amount of part-time work and still draw UI benefits. Although virtually all the states allow claimants to work part-time to some degree, Montana is unique in that certain features of the Montana UI law allow certain claimants working part-time to be considered "totally unemployed" while in all other states they would be considered partially employed (page 133). In Montana claimants can work 12 hours and earn twice the weekly UI benefit. Any excess hours or earnings result in disqualification (page 134).

Most states allow for partial employment by disregarding a portion of part-time earnings. They disregard from earnings either a fixed

dollar amount, a portion of the weekly UI benefit, or some combination of the two (page 134). These laws allow a fraction of earnings to encourage acceptance of part-time work but provide for a reduction of benefits to avoid payments when claimant's earnings are substantially above the basic benefits (page 135). Montana law relative to part-time employment does not effectively consider earnings (page 135).

The circumstances observed during our examination suggest that both employers and claimants can abuse the provisions of the UI laws enabling part-time work and earnings while receiving UI benefits (page 142).

A dollar for dollar reduction of UI benefits for part-time earnings results in a work disincentive. On the other hand, too high an allowance for part-time earnings results in a wage subsidy program which of course is not what the UI program is intended to be--the disregarded amount should be kept small (page 143).

RECOMMENDATION (page 143)

We recommend that legislation be enacted to amend Section 87-149(a)(3), R.C.M. 1947, to eliminate the provision allowing the twelve hours and earnings twice the weekly benefit amount and provide for a partial unemployment provision allowing a sliding scale reduction for earnings at less than full employment.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

The UI laws in Montana also allow a retired worker to receive both retirement or pension pay and UI benefits provided he is otherwise

qualified for UI benefits. Currently under Montana law there is no disqualification or reduction of UI benefits paid retirees unless the pension amount exceeds two times the average weekly UI benefit amount of the prior fiscal year and retiree's earnings or wage credits used to compute the UI benefit amount are from the same employer contributing to the pension payment. (Federal and Social Security pensions are exempted.) Any retiree who returns to work and earns sufficient qualifying wages from another employer is eligible to draw benefits regardless of the pension amount received (page 143). During the 18-month period included in our examination retiree claimants received an average weekly UI benefit of $54.20 while receiving an average weekly pension amount of $52.39 (page 146).

Of the states providing disqualification, Montana's law is one of the more lenient. The laws of 12 states contain provisions requiring the deduction of Social Security pensions from the computed weekly UI benefit of which a retired worker is eligible (page 145). Thirteen states deduct payments of other employer pensions including federal and military pensions from the computed weekly UI benefit and an additional 21 states deduct the pension payment of a qualifying base period employer including federal and military (i.e., the pension is paid by the employer whose wage credits are used to determine eligibility and compute the weekly UI benefit). Eleven states have no disqualification or deductions for receipt of pensions whatsoever (page 145).

New federal legislation requires that state unemployment insurance laws preclude payment of benefits to a retiree whose pension resulting from employment from whatever source exceeds the weekly benefit amount and provides for reduction of weekly benefits where the pension amount

on a weekly proration does not exceed the weekly benefit amount. Montana's current UI law will not be in conformance with the new federal law unless either the federal law or the Montana law is changed (page 146).

Simply considered, claimants who are voluntarily or involuntarily retired are, in effect, removed from the work force. Retirees who receive a pension or retirement pay from their previous employers are, in effect, still receiving pay or compensation as a result of their previous employment. While they may be unemployed in a technical sense, they are not unemployed from a practical standpoint. They are retired. The Montana law needs to be changed (page 153).

RECOMMENDATION (page 153)

We recommend that legislation be enacted amending Section 87-106(g), R.C.M. 1947, to:

1. *Preclude all retirees from receiving UI benefits based upon preretirement employment with the employer from whom they retired.*
2. *Require retired employees to reestablish their right to UI benefits subsequent to retirement by meeting the statutory work and earnings requirements.*

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

Under Montana's UI law, claimants involved in labor disputes receive unemployment insurance benefits under certain circumstances in Montana (page 154).

The granting or denying of benefits involving a labor dispute is generally followed by appeals within levels of state government and sometimes into district court. Since 1972 there has generally been an increasing trend of appeals for labor dispute claims with 19 occurring in 1975. The payment of UI benefits to claimants involved in labor disputes is costly--$90,000 for three instances still being appealed and seems to violate the neutrality of the state in labor disputes (page 155).

State laws involving labor disputes do not question whether unemployment is incurred through the fault of the worker but rather intend to mark out an area that is excluded from coverage based on the premise that a neutral position must be maintained in labor disputes (page 160). Montana law prohibits payment of benefits to an individual whose unemployment "is due to a stoppage of work which exists because of a labor dispute." What constitutes a "stoppage of work" has not been decided by the Montana Supreme Court. However, the Supreme Courts in many other states have interpreted the phrase "stoppage of work" to mean a total cessation of operations by a plant or facility, while other courts have held that a "stoppage of work" refers only to the individual employees (page 160). Further, a federal district court has struck down an almost identical Hawaii law because state payments to strikers and others involved in labor disputes intrude into the area of labor law occupied by the National Labor Relations Act (page 161). The Montana payments in these instances appear the result of ambiguities in the law which twelve other states have corrected by amendment of statutes (page 162).

RECOMMENDATION (page 163)

We recommend that legislation be enacted to amend Section 87-106, R.C.M. 1947, to clarify the neutrality of the state in labor disputes.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

The attorney who represents the division also provides legal representation for the Board of Labor Appeals. This dual role presents a conflict of interest in every instance in which the board decision is contrary to the division's interpretation of statutes and regulations. As a result, it prevents an aggressive defense of the division's position since the same attorney would be called upon to represent the board should the matter be appealed to district court (page 163).

RECOMMENDATION (page 164)

We recommend that the Department of Labor and Industry make appropriate arrangements to provide the Board of Labor Appeals with its own attorney.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

CHAPTER V. LOCAL OFFICE ELIGIBILITY DETERMINATION AND JOB SERVICE

The initial determination made by the division concerns the nonmonetary aspects of eligibility such as the reason for separation from work and the monetary amount due the unemployed worker. Except for a limited delegation of authority to some local offices, continuing or subsequent eligibility determinations are made on the basis of data obtained at the local office and transmitted to the central office. Subsequent determinations are of a nonmonetary nature and relate to availability, seeking and refusal of work. Our principal interest in the subsequent determinations relates to placement of unemployed workers in jobs thereby removing them from the unemployment rolls. Obviously, an unemployed worker who is not available, not seeking, or refusing suitable work cannot become employed as easily as one that pursues a rigorous job search (page 165). The impact of good or poor eligibility determinations is felt in two ways--first, the unemployed worker has an absolute requirement to seek employment with an objective of returning to work as soon as possible; second, other currently employed workers who may contemplate voluntarily quitting their jobs to collect unemployment will respond by retaining their currently held jobs in the face of a fair but stringent eligibility determination process. Studies on the subject support the fact that unemployment is increased by lenient application of eligibility rules (page 167).

Our review at nine local offices around the state disclosed that improvements could be made in the area of eligibility determinations (page 168).

Our random sample and review of recent claimants' files showed that there is a substantial breakdown of vital information at the initial

stage--only 25 percent of the employers answer the request to confirm claimant separation data. In the absence of the employer statement, the local office generally makes no followup and proceeds on the assumption that the claimant's statement is correct. Accordingly the first step in eligibility determination--confirmation of the reason for unemployment--is not accomplished for 75 percent of the claimants (page 168).

RECOMMENDATION (page 170)

We recommend that the division institute follow-up measures necessary to insure that employers provide information needed by the division to determine eligibility.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

The determination of whether the claimant is available and seeking employment is a matter of continuing scrutiny by the local office. Generally greater emphasis is intended to be focuwed on claimants who do not show serious attachment to the labor market--really do not want to work--in contrast to those who have a strong attachment--really want a job. Procedures are established to require judgmental grouping of claimants to enable more intensive processing for claimants who show less serious attachment to the labor market (page 170). However, review of local office files selected randomly shows that 44 percent of the claimants are not so classified and consequently a large number are never reinterviewed. Thus, the continuing eligibility process has begun to weaken before it starts simply because an established procedure

is not being followed (page 171). Additionally, on numerous occasions when the claim supplement showed that the claimants had not contacted a single potential employer we found no evidence of disqualification issues being raised (page 171). The local offices as a general rule are not raising disqualification issues where job search has been inadequate (page 172).

We also found that there was no attempt by the local offices to verify whether the claimants are actually contacting the employers who they say they have contacted (page 172). The value of properly evaluating each claimant's continuing eligibility was aptly demonstrated by one office which we visited. That office conducted intensive reinterviews of claimants and found a substantial percentage were not eligible for benefits (page 172).

It is obvious that increased job search caused by more stringent enforcement of the various requirements for eligibility would substantially reduce unemployment and the disbursement from the UI trust fund (page 174).

RECOMMENDATION (page 175)

We recommend that the division take measures to strengthen the unemployed workers' job search process by:

1. *Requiring local offices to:*
   - A. *Classify unemployed workers as prescribed to enable a more intensive focus on those most unlikely to seek employment.*
   - B. *Require claim supplements at more frequent intervals to enforce a more aggressive job search for unemployed workers.*

C. *Perform random checks of the indicated potential employer contact to verify the job search.*

D. *Intensify the periodic reinterview process as accomplished by the Billings local office for the specific purpose of determining continuing eligibility.*

E. *Submit disqualification issues to the central office whenever the unemployed worker fails to meet predetermined standards for availability, job search, or refusal of suitable work.*

2. *Revise current guidelines provided to local offices to emphasize the importance of the job search requirement.*

3. *Revise the claim supplement and reinterview forms to indicate possibility of checking with the potential employer and potential disqualification if job search is inadequate.*

4. *Intensify field supervision of local offices to obtain the desired disqualification issue identification.*

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

The local offices also provide job service or placement service in conjunction with the provisions of UI benefit claim service. The job service function essentially complements that of the insurance function in that both are intended to resolve economic insecurity caused by loss of jobs (page 176).

The job service office attempts placement of applicants by matching available applicants for the job openings (page 176). A key to this is the occupations listed for each applicant. Although most applicants have a work history of more than one occupation, the local offices normally use only one occupation in trying to place applicants. We found that 81 percent of the claimants are willing to accept jobs in other than their regular line of work. A large percentage of claimants we contacted also indicated that they actually changed occupations when jobs were obtained (page 177). The use of more than a single occupational code has potential for earlier placement of job applicants, obviously because applicants could be matched to a greater number of job openings (page 178).

RECOMMENDATION (page 178)

We recommend that the division implement procedures to require the use of additional occupational codes for qualified applicants.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

Local job openings were not posted on the "Job Information Bulletin Board" in seven of the nine local offices we visited (page 178). Office managers at these two locations reported that the posting of local job orders was successful with applicants and that it saves interviewer time because applicants provide "self-screening" (page 179).

RECOMMENDATION (page 179)

We recommend that the division require local offices to display job orders without disclosure of the employer name.

While the division informally expressed general agreement with the recommendation, the formal reply submitted by the division does not specifically address the issue (page 197).

* * *

Intrastate matching of applicants and jobs is a cumbersome process and in some instances not available. Most of the job matching is accomplished manually which generally precludes widespread intrastate consideration for all but a few hard to fill positions. Even the procedures established to circulate hard to fill positions are manual and often result in outdated information being circulated (page 180). There are data processing equipment and techniques which would facilitate and expedite the handling, storage, and retrieval of information and data about job applicants and job openings. Data processing services currently in use by other state agencies such as remote terminals, visual display terminals, and other such equipment tied directly into the state data processing center would allow direct input, compilation, comparison, search and output of job related information by the various elements within the division including some of the local offices (page 182).

Other states have already designed and implemented an automated job bank system, and the division should determine the feasibility of such systems in Montana (page 180).

RECOMMENDATION (page 183)

We recommend that the division continue to study the feasibility of a fully automated job match system in Montana.

The division agrees that an automated job match system would be desirable but has not been feasible due to funding and operational limitations. The division said it is working toward such a system (page 197).

* * *

ADMINISTRATIVE OFFICIALS

EMPLOYMENT SECURITY DIVISION

Fred Barrett	Administrator
Chester C. Rusek	Deputy Administrator for Administrative Services
C. C. Warner	Deputy Administrator for Employment Services
Harold Kansier	Deputy Administrator for Unemployment Insurance

DEPARTMENT OF LABOR AND INDUSTRY

Sidney T. Smith	Commissioner

Chapter I

INTRODUCTION

This report is a result of our program audit of certain operations of the Employment Security Division of the State Department of Labor and Industry. This audit supplements our earlier financial/compliance audit of the Employment Security Division. The results of that audit (Report on Examination of Financial Statements) were published in a report issued in May, 1976.

ORGANIZATION OF THE REPORT

This report is presented in five chapters.

Chapter I presents an introduction to the report and summarizes the scope and general direction of the audit and this audit report.

Chapter II presents a background of the unemployment insurance program in the U.S. and in Montana. It is intended to familiarize you with the history and current operations of unemployment insurance so as to facilitate an understanding of the issues discussed in the remaining chapters.

Chapter III is a detailed commentary on the tax system that finances the unemployment insurance program. Issues and problems with the current tax system are discussed. Recommendations are presented at various points in the chapter to resolve the issues and problems and to strengthen and improve the financing activities.

Chapter IV presents an evaluation of unemployment insurance benefits and discusses areas where measures should be taken to strengthen and improve the effectiveness of the unemployment insurance program. These measures are presented in the form of recommendations throughout the chapter.

Chapter V discusses eligibility for unemployment benefits and the effectiveness of the job search process. Recommendations are also made in this chapter.

Finally, the substance of this report was discussed with officials of the division. Their views, comments and suggestions were considered in the formation of the report. Due to time limitations, the division was unable to furnish a detailed reply to the report. However, the general reaction of the division to this report is included separately at the back of the report.

OBJECTIVES OF THE AUDIT

The objectives of the audit were:

1. To determine the effectiveness of the systems and procedures which underlie the financing of the unemployment insurance program in Montana.
2. To determine whether the payment of unemployment insurance benefits in certain circumstances meets the stated purpose and goals of the unemployment insurance program.
3. To assess the effect of more rigorous job search requirements on the payment and duration of unemployment insurance benefits.

SCOPE OF THE AUDIT

The audit focused on the unemployment insurance functions of the Employment Security Division of the State Department of Labor and Industry. We examined the criteria and procedures used by the Employment Security Division to finance the unemployment insurance program and pay unemployment insurance benefits to individuals who were unemployed. As a part of this examination, we evaluated selected aspects of the eligibility determination and job search processes in the Helena office and selected local offices around the state.

The audit did not include an evaluation of the claim process, the overall eligibility determination process, or the fraud detection program. Similarly, the audit did not encompass the internal financial/compliance operations of the Employment Security Division since those matters were addressed in our financial/compliance audit and resultant audit report published in May 1976.

Chapter II

BACKGROUND ON UNEMPLOYMENT INSURANCE

As the name connotes, unemployment insurance is insurance. Insurance is generally issued against risk which falls into three categories: (1) personal loss, (2) property loss, and (3) liability losses. Unemployment insurance is insurance against the risk of personal loss (wage loss) due to unemployment.

Unemployment is a social insurance program. It is an "insurance" program in that it meets the basic criteria of insurance: involuntary risk, economic loss, verifiable risk, the law of large numbers, only partial exposure to loss at any given time, and predictability.[1] It is "social" insurance in contrast to private insurance in that it involves the general population and is based upon factors which can be changed unilaterally by government.

RIGHT VERSUS NEED

One of the major characteristics of unemployment insurance (UI) as an insurance program, is that it is based upon "rights" rather than "needs." This is an important distinction and is what makes UI different from public assistance or welfare. It is also often a point of controversy. It is conceivable under the UI program in Montana and throughout the country that a wealthy worker could draw UI. His wealth or lack of wealth would have no bearing on his "right" to UI. So long as he has become qualified for UI by meeting the employment requirements of law, he has a "right" to UI. This characteristic of the UI program should be kept in mind when considering this report and the nature of UI insurance in general.

The unemployment insurance program in Montana is part of a nationwide program undertaken as a joint venture by each of the 50 states, the

District of Columbia and Puerto Rico with the federal government. Almost every aspect of the UI program in Montana and the other states is in some way related to the federal government either as a direct or an indirect result of federal legislation and federal guidelines.

ORIGINS OF UNEMPLOYMENT INSURANCE

Prior to serious consideration of UI in the United States, 19 European countries and Canada had nationwide unemployment insurance programs of either a compulsory or a voluntary nature.

In the United States, some type of insurance for the unemployed began as early as 1831 under a trade union. In the early 1900's a large number of unemployment benefit and guaranteed employment plans were worked out by joint agreements between trade unions and management. In some instances, the unemployment benefit plans were supported by employer contributions while in other instances they were financed by joint contributions. About the same time a large number of "company plans" were initiated by large firms. When UI became a topic of serious consideration on a national scale, representatives of most of these firms testified favorably at state and federal legislative hearings.[2]

Attempts at State Legislation

Although UI eventually came about as a result of the Great Depression, the concepts underlying UI in the states existed much earlier. Prior to 1920, many state legislatures had discussed the desirability of some form of UI. As a general rule, however, each was unwilling to levy a tax against its employers that was not also levied by adjacent states lest it give the adjacent states a competitive advantage in the attraction and development of businesses and industry.

The state of Wisconsin pioneered state UI legislation. In 1921, a bill was introduced in the Wisconsin legislature to establish a statewide UI plan entirely financed by employers. In spite of general support by labor and several employers, the prospective legislation was defeated. The bill was eventually reintroduced in a number of succeeding legislative sessions, but was defeated each time through 1929--once by one vote in 1923. During the 1920's, 22 measures to establish UI programs were introduced in the legislatures of seven states, but none of the legislation passed.

In 1931 the legislature in Wisconsin reconsidered measures establishing a statewide UI program, and in January 1932 Wisconsin enacted legislation creating the first statewide UI program in the United States. Shortly thereafter numerous other states undertook serious consideration of UI, but no other states passed laws establishing UI programs. However, many of the states established study commissions most of which, by 1934 recommended the Wisconsin or similar type of UI laws. Again, there was widespread concern among the individual states that they would lose a competitive edge. Consequently, UI laws were not enacted and a stalemate of sorts existed.[3]

Federal Action

During the period of legislative consideration by the states, consideration of UI was also taking place at the federal level. In 1916, a socialist representative introduced a resolution in Congress calling for a national insurance commission and for the end of unemployment. Opposing the resolution, representatives of labor expressed the view that labor was in favor of a system of voluntary unemployment insurance. Primarily due to opposition by labor, the resolution failed.[4]

The first actual federal UI bill was introduced in the Congress in 1928 but no action was taken. As the depression grew worse, the need for unemployment relief also grew. From 1931 through 1934, the Congress deliberated and progress toward some type of UI program was made. However, in 1934, President Roosevelt, who had vetoed UI legislation as governor of New York, announced he was in favor of federal UI legislation but preferred to delay action on such legislation pending the outcome of a comprehensive study of social insurance.[5]

The United States Social Security Act

Recognizing that some form of federal legislation was necessary to break the stalemate among the states and further recovery from the depression, President Roosevelt appointed a Committee on Economic Security which undertook an in-depth study of UI. In August 1935 a federal UI program was enacted as a part of the United States Social Security Act of 1935. The programs included in this landmark legislation--unemployment insurance, social security (old age assistance), and public assistance (welfare)--were all intended to provide for individuals when economic conditions beyond their control limit their ability to provide for themselves. They were controversial programs generating intense opposition when they were enacted and for years after.[6]

The United States Social Security Act became the basis for a national UI program. As finally enacted by the Congress (and later incorporated as a part of the Internal Revenue Code and referred to as the Federal Unemployment Tax Act--FUTA), the federal legislation established a federal-state unemployment system. The federal-state system was preferred for several reasons: because the depression-level unemployment had national roots requiring national solutions; because of a fear of imposing a uniform system in a diversified United States economy; and

primarily because it was expected that a purely federal system would be declared unconstitutional by the United States Supreme Court.[7]

Under the federal law, states were individually free to join or not to join the system and to adopt coverage and benefit provisions as they saw fit. As a means of "encouraging" states to join, the law specified that covered employers had to pay a federal tax equal to 3.0 percent of their total payroll. The tax was due the federal government whether or not the state had a UI law. However, employers in those states which had a law meeting the federal criteria could deduct 90 percent (or 2.7 percent of 3.0 percent) of the federal tax liability by paying this portion to the state UI program. The states had various options open to them--narrower or broader coverage--but since the narrower coverage penalized employers, who had to pay the federal tax anyway, there was little incentive for the states to adopt lower options. In effect, the states had a choice of joining or not joining a UI program which cost them nothing because employers paid the same tax in any event.

By 1938 every state, as well as the then territories of Alaska and Hawaii, and the District of Columbia, had joined the system.[8]

HISTORY OF UNEMPLOYMENT INSURANCE IN MONTANA

Little information has been collected about the early history of UI in Montana. Public employment services were carried out on a limited scale in the state during World War I by representatives of the U.S. Employment Service who recruited workers for war production plants. This program was discontinued by the federal government in 1920 but a similar program was reinstituted in 1933 for the purpose of manning work-relief programs in conjunction with the effort to recover from the depression. To accomplish this program, the U.S. National Reemployment Service established employment offices in each county of the state.[9]

As previously mentioned, the U.S. Social Security Act--establishing the federal-state partnership in UI--was enacted in August 1935, too late for consideration by the 1935 Montana Legislature.

Development of Montana's Unemployment Insurance Program

In 1937, the Legislature enacted Montana's UI program. The bill (House Bill 344), entitled the "Unemployment Compensation Law," was approved on March 16, 1937, and took effect immediately as Chapter 137, laws of 1937. The purpose of the program was explicitly described by the original act and has remained the same up to the present as expressed in Section 87-102, R.C.M. 1947:

"DECLARATION OF STATE PUBLIC POLICY

> "Section 2. As a guide to the interpretation and application of this Act, the public policy of this State is declared to be as follows: Economic insecurity due to unemployment is a serious menace to the health, morals, and welfare of the people of this State. Involuntary unemployment is therefore a subject of general interest and concern which requires appropriate action by the legislature to prevent its spread and to lighten its burden which now so often falls with crushing force upon the unemployed worker and his family. The achievement of social security requires protection against this greatest hazard of our economic life. This can be provided by encouraging employers to provide more stable employment and by the systematic accumulation of funds during periods of employment to provide benefits for periods of unemployment, thus maintaining purchasing power and limiting the serious social consequences of poor relief assistance. The legislature, therefore, declares that in its considered judgment the public good, and the general welfare of the citizens of this State require the enactment of this measure under the police powers of the State for the compulsory setting aside of unemployment reserves to be used for the benefit of persons unemployed through no fault of their own."

The federal origins of the UI program in Montana are explicit in the text of the Montana law. For example, Section 22 of the act provided for immediate termination of the Montana UI program if the federal Social Security Act was declared unconstitutional. Second, Section 23

of the act specifically stipulated that the Montana UI program would also immediately terminate if the federal Social Security Board failed to approve the Montana act. The federal Social Security Board approved the Montana program and, as a consequence, Montana commenced the formation of the administrative machinery to operate the UI program.

The law created a new and independent agency called the Unemployment Compensation Commission supervised by three commission members appointed by the governor. The new state agency commenced limited operations in April 1937.

The law organized the Unemployment Compensation Commission into two divisions: the state Employment Service Division and the Unemployment Compensation Division. The Employment Service Division was established as a distinct operation to meet the federal criteria underlying the entire UI program. It was established for the purposes of (1) providing free public employment offices throughout the state, and (2) assuming eventual control and operation of the U.S. National Reemployment Service functions in Montana.

Establishment of the state Employment Service proceeded in 1938 with the state agency acquiring the records, facilities, equipment, supplies and, in most cases, the personnel of the U.S. National Re-employment Service in Montana. Soon the employment service broadened to encompass employment services to private employers and industry. Inasmuch as the Unemployment Compensation Commission was also charged with paying unemployment benefits, the primary direction of effort was to put workers back to work, thereby conserving unemployment compensation funds. The prevailing thought was that workers would be better off, the employers would have the workers they needed, and society as a whole would be benefited.[10]

In July 1939 Montana began paying unemployment compensation benefits. The state employment offices around the state were used as claims-taking offices. Both the employment service and unemployment compensation operations were underway when World War II broke out, resulting in a substantial changes in wartime operations of industry and the labor market. The labor market was suddenly reversed--instead of a shortage of jobs there were suddenly many jobs.

In response to a presidential request of all states in 1941, the employment service operations of the Unemployment Compensation Commission were transferred for a temporary-emergency period back to the federal government. However, complete separation of the agency operations never really occurred since the personnel conducting the unemployment compensation functions of the state agency generally occupied office quarters with those personnel temporarily transferred to the federally operated employment service. The paper separation continued for nearly five years--until November 1946--when the federal government transferred the employment service operations back to the state.[11] Ever since that time the unemployment compensation and employment service functions have been conducted by the state agency.

Current Functions

In 1969 the name of the agency was changed by law (Section 1, Chapter 132, Laws of 1969), from the Unemployment Compensation Commission to the Employment Security Commission; the name of its employment compensation division was changed to the Unemployment Insurance Division. In 1971 the Executive Reorganization Act (Section 1, Chapter 272, Laws of 1971) and Executive Reorganization Order 11-71, abolished the Employment Security Commission and created (1) a new state department--the Department

of Labor and Industry, and (2) two new units within the department dealing with labor--the Board of Labor Appeals and the Employment Security Division.

The quasi-judicial functions of the UI program (hearing and resolving employee and employer appeals) were transferred to the newly created Board of Labor Appeals which is attached to the department for administrative purposes. The employment service and UI functions of the UI program were transferred to the newly created Employment Security Division. One of the more substantial changes of the Executive Reorganization was the abolishment of the prior three-member commission and the provision for appointment of an administrator of the division by the commissioner of the department. While there were also other changes made, the operations of the UI and employment service program remained essentially the same.

Organization and Staffing

The division is currently organized into three bureaus: administrative bureau, employment service bureau, and unemployment insurance bureau. The current organization and number of personnel of the division is depicted in Appendix A on page 186. As the title connotes, the administrative bureau is responsible for the internal administrative operations of the division. The unemployment service bureau administers the UI program, including the assessment and collection of UI taxes and the payment of UI benefits. The employment service bureau operates 23 local employment offices around the state and is responsible for a wide range of employee and employer related services including recruitment of workers, job placement, counseling, testing, selection for training, and labor information. In addition, employment service bureau personnel in the local offices act as the initial point of contact and receive

applications for UI filed by unemployed workers. The location and number of personnel of the local job service offices around the state is depicted in illustration 2.1.

Illustration 2.1
CITIES WHERE JOB SERVICE OFFICES ARE LOCATED

	City	No. of Personnel		City	No. of Personnel
1.	Anaconda	5	13.	Kalispell	24
2.	Billings	68	14.	Libby	5
3.	Bozeman	15	15.	Lewistown	5
4.	Butte	33	16.	Livingston	6
5.	Cut Bank	6	17.	Miles City	6
6.	Dillon	3	18.	Missoula	38
7.	Glasgow	6	19.	Polson	5
8.	Glendive	4	20.	Shelby	3
9.	Great Falls	51	21.	Sidney	4
10.	Hamilton	5	22.	Thompson Falls	3
11.	Havre	6	23.	Wolf Point	2
12.	Helena	34			

Source: Compiled by the Office of the Legislative Auditor from data provided by the Employment Security Division.

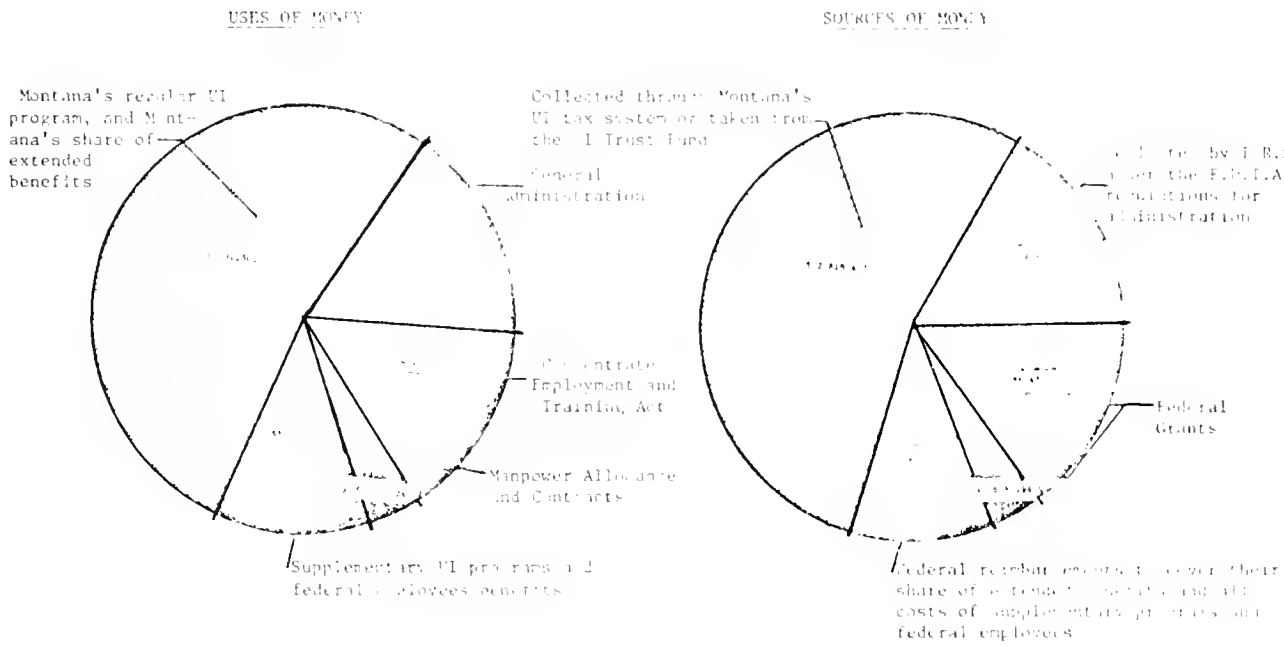
Operations and Financing

As previously mentioned, the UI program in Montana and throughout the U.S. is a partnership or joint venture between the federal government and the respective states. All of the state UI programs operate under general criteria established by federal laws and regulations.

As a general rule, the operations of the division in terms of finances fall into two general categories--administrative operations and UI benefits. These two categories also roughly depict the source of money for the operations of the division. The administrative operations--including internal administration, employment service activities, UI benefit administration and special federal manpower or concentrated employment programs are financed by federal grants. Some of the money for these federal grants comes from federal UI taxes on employers. In contrast, the UI benefits in Montana are almost all financed directly

by the UI tax on employers in Montana. The exceptions are special federal programs which provide for extended or supplemental UI benefits. These programs are financed on a 50 percent federal-50 percent state basis in the case of extended UI benefits and on a total federal basis in the instance of supplemental UI benefits. The source, level, and nature of the federal and state UI taxes are described in greater detail in Chapter III. The source and use of money by the division during fiscal year 1974-75 (most current data available) is depicted in illustration 2.2. The dark shaded area represents money collected or spent in conjunction with federal programs. The light shaded area is state money.

Illustration 2.2
MONTANA EMPLOYMENT SECURITY DIVISION
Fiscal Year 1974-75



Source: Compiled [illegible] Statements, [illegible] of the Legislative Auditor, May [illegible]

THE UNEMPLOYMENT INSURANCE PROGRAM

The UI program in Montana is similar in many respects to the UI programs in other states. This is because all of the UI programs have their origins in the federal UI program. But there are also some substantial differences among the states. For the most part these differences are discussed in more detail in the relevant sections of the remaining chapters of the report.

Covered Employment

One of the areas where states are very similar is in the area of covered employment. Generally, all employers in Montana with a total annual payroll of $500 or more are required by law (Section 87-148(i)(1), R.C.M. 1947) to participate in the UI program. Similarly, state agencies and political subdivisions of the state, including counties, cities, towns and school districts, are also required by law to participate in UI. Finally, nonprofit organizations (defined as tax exempt under the U.S. Internal Revenue Code) must participate in the UI program.

The law (Section 87-148(j)(9), R.C.M. 1947) is also specific as to what areas of employment are excluded from the state UI program. Basically, there are eleven categories of excluded employment:

1. Agricultural labor
2. Domestic service
3. Vessel officer or crew member
4. Services in the employ of a son, daughter or spouse, or child under 18 in employ of parents
5. Federal employees*
6. Service for an organization covered by unemployment compensation due to an act of Congress*

7. Newspaper distribution and delivery by individuals under 18 years of age
8. Real estate, securities and insurance sales based on commissions
9. College students and spouses employed by colleges
10. Student employment as a part of academic instruction
11. Patients employed by a hospital

*Federal employees and ex-servicemen are covered by U.S. Government programs.

With the exception of governmental agencies and nonprofit organizations, covered employers in Montana are required to pay an UI tax to the division. State and local governmental agencies are required (Section 87-109(b)(1), R.C.M. 1947) and nonprofit organizations may elect to make payments in lieu of UI tax contributions. As a general rule, governmental units pay a tax of .4 percent of gross wages for the first three years of coverage. Then new rates, based on actual costs of benefits drawn against their accounts, are given to each unit. Non-profit organizations, (other than governmental units), reimburse the division at the end of each quarter for benefits charged against their accounts.

As previously mentioned the manner and extent to which the UI tax is levied on covered employers in the state is discussed more fully in Chapter III--The Tax System that Finances Unemployment Insurance. The extent to which employees are entitled to UI benefits is discussed more completely in Chapter IV--Unemployment Insurance Benefits.

Unemployment Insurance Benefit Programs

Another area of similarity among the states is various programs under which UI benefits are paid. Basically there are eight programs in Montana involving UI benefits. Some of these programs are temporary in

nature while others are special programs created for special groups of unemployed people. The eight programs are summarized below.

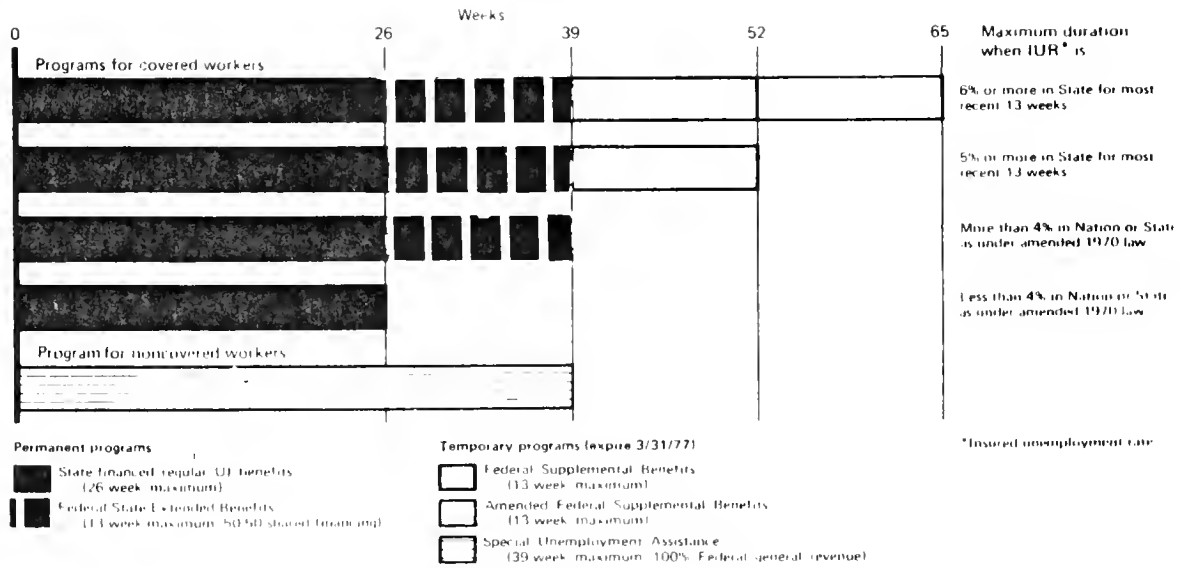
1. Regular UI Benefits--The basic state UI program paid for by employers in the state--100 percent state financed--and providing up to 26 weeks of UI benefits.
2. Federal-State Extended Benefits--Triggers in as the unemployment level goes up--financed 50/50 by the federal and state governments--provides up to 13 additional weeks of UI benefits to those who have exhausted their basic UI benefits.
3. Federal Supplemental Benefits--Triggers in at higher unemployment levels--financed 100 percent by the federal government--provides up to 13 additional weeks of UI benefits to those who have exhausted the basic and extended benefit programs.
4. Federal Modified Special Benefits--A special temporary program financed 100 percent by the federal government but recently terminated--available to those who exhausted the basic and two extended benefit programs--provided up to 13 weeks of additional benefits.
5. Special Unemployment Assistance Benefits--Another special temporary program still in force--financed 100 percent by the federal government--available only to those ineligible for regular UI benefits--provides benefits for up to 39 weeks. No new claims can be accepted after December 31, 1977.
6. Unemployment Insurance for Ex-Servicemen--100 percent federally financed--provides UI benefits for recently separated servicemen who otherwise meet the criteria for the regular UI benefits.

7. Unemployment Compensation for Federal Employees--also 100 percent federally financed--provides UI benefits for former federal employees who otherwise meet the criteria for regular UI benefits.

8. Trade Readjustment Allowance--100 percent federally financed--benefits to workers who lose their jobs or incur reduced wages as a result of trade with other countries.

As previously mentioned some of the foregoing UI benefits are special in nature. Excluding those programs, it is possible for an unemployed worker to draw UI benefits for up to 65 consecutive weeks if all the temporary UI programs are triggered. The following illustration depicts the number of weeks unemployed individuals can draw benefits under the basic, temporary, and special programs.

Illustration 2.3
STATE AND FEDERAL UNEMPLOYMENT INSURANCE PROGRAMS



Source: U.S. Department of Labor Document, Employment and Training Report of the President, June 1976, p. 89.

While 65 weeks may seem like a prolonged and possibly unusual period of time, payment of UI benefits for such a period has been common in Montana recently. This is probably to be expected as a result of the unemployment conditions which have prevailed in Montana and the U.S. during recent years. In many respects, this is the purpose of the regular and special UI programs--to react to the economic conditions.

THE UNEMPLOYMENT RATE

Most measures of unemployment indicate that the 1974-75 recession exceeded all recessions since the Great Depression of the 1930's. In fact, approximately one-third of the $100 billion paid in benefits in the United States since 1937 was paid during 1975 and 1976.[12] Contrary to these indications, some economists argue that other measures, such as the number of employed persons as a percent of the working age population, more accurately estimate the true state of the economy.[13] These and others also contend that unemployment of the 1970's does not resemble the unemployment of the 1930's.[14] They point out that there are almost as many job openings as unemployed in the United States. This was not the case in the 1930's--there were no jobs available. The current unemployed, about 7.5 million, also differ in how they became unemployed. Only about half of them left work involuntarily. The others voluntarily quit or just entered or re-entered the labor force. In addition, most unemployment has a shorter duration than in the 1930's. Nationally, in 1974, 51 percent of the unemployed had been out of work for less than five weeks and only 7.3 percent were unemployed for over 27 weeks. Finally, over the past decade the average company has rehired 85 percent of the same people it previously laid off.[15]

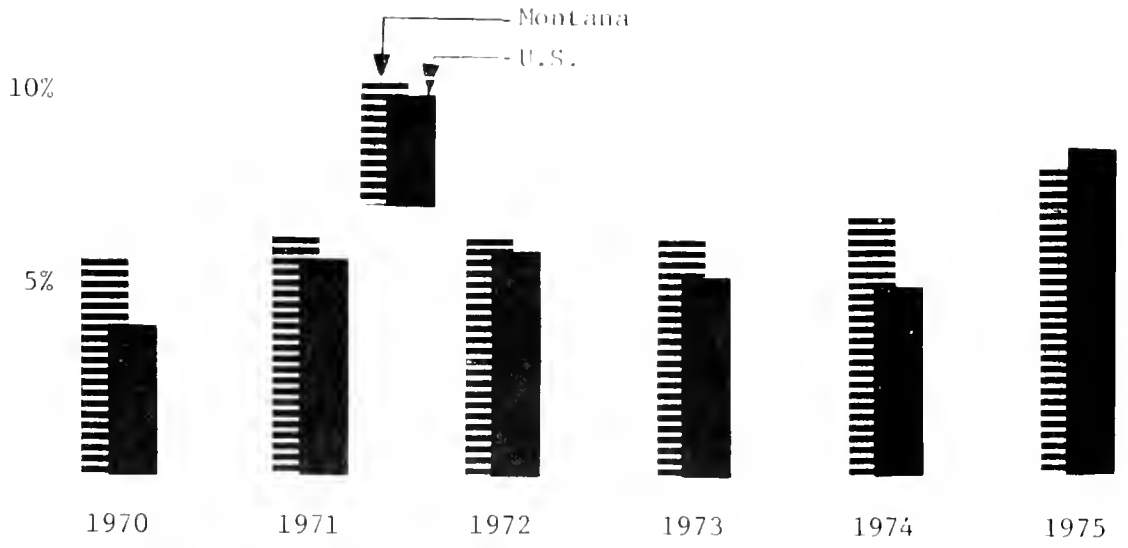
Martin Feldstein of Harvard University sums up the new unemployment as follows:

"The picture of a hard core of unemployed workers who are not able to find jobs is an inaccurate description of our economy and a misleading basis for policy. A more accurate description is an active labor market in which almost everyone who is unemployed will soon return to his original job or can find a new job in his usual type of work in a relatively short time. . .

"To lower the permanent rate of unemployment requires structural reforms and specific policies aimed at the three primary sources of high unemployment: teenage unemployment, the chronic "unemployables," and the excessive temporary unemployment that is induced and exacerbated (extended) by unemployment insurance."[76] (Parenthetical added)

Irrespective of the foregoing, unemployment has been very high. The following illustration depicts the unemployment level in the United States and Montana since 1970.

Illustration 2.4
UNEMPLOYMENT RATES IN MONTANA AND THE U.S.
1970 - 1975



Source: Compiled by Office of the Legislative Auditor on basis of Employment Security Division data.

Note: Montana and the United States derive their estimates of the unemployment rate from different sources: United States rates from sampling and statistical methodology; Montana from covered employment data. These rates represent the best available data.

Historically, Montana's unemployment rate has generally exceeded the national average. The 1975 recession hit industrialized states harder than agricultural states. Therefore, contrary to historical trends, the national unemployment rate for 1975 surpassed Montana's.

While the unemployment in Montana may seem high, there are a large number of states with higher unemployment rates. Illustration 2.5 depicts this for 1975.

Illustration 2.5
1975 UNEMPLOYMENT RATES BY STATE

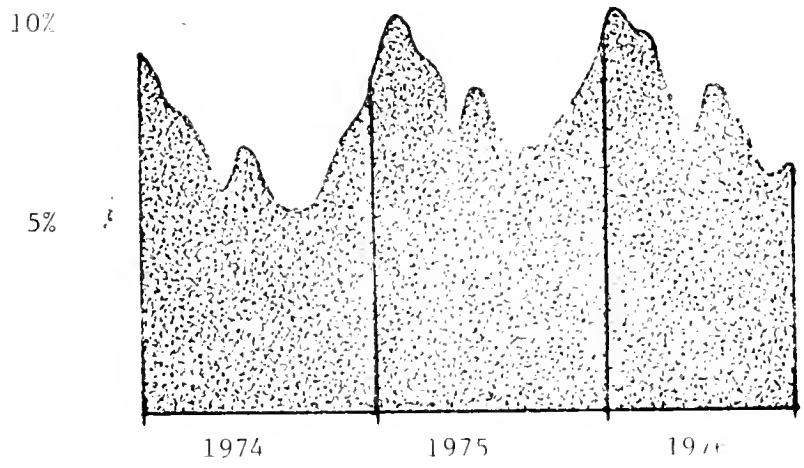
1	Wyoming	4.5	19	Hawaii	7.5	37	Washington	9.4
2	So. Dak.	4.8	20	W.Virginia	7.5	38	Nevada	9.7
3	Kansas	4.9	21	Kentucky	7.6	39	California	9.9
4	Colorado	5.0	22	Arkansas	7.6	40	Arizona	10.0
5	No. Dak.	5.2	23	No. Car.	7.6	41	Vermont	10.0
6	Nebraska	5.4	24	New Mexico	7.7	42	Maine	10.1
7	Iowa	5.7	25	Dist. Col.	8.1	43	Oregon	10.1
8	Minnesota	6.0	26	MONTANA	8.1	44	New York	10.1
9	Texas	6.1	27	Louisiana	8.2	45	Conn.	10.2
10	N. Hamp.	6.7	28	Illinois	8.3	46	New Jer.	10.3
11	Virginia	6.7	29	Ohio	8.4	47	So. Car.	10.9
12	Oklahoma	6.9	30	Indiana	8.7	48	Florida	11.4
13	Missouri	7.1	31	Tennessee	8.7	49	Mass.	13.2
14	Wisconsin	7.1	32	Alabama	8.8	50	Michigan	13.7
15	Maryland	7.2	33	Pennsyl.	8.9	51	Rh.Island	14.4
16	Utah	7.2	34	Oklahoma	9.0	52	P.Rico	14.9
17	Idaho	7.3	35	Delaware	9.1			
18	Miss.	7.5	36	Georgia	9.4			

Average for U.S. 8.5%

Source: Labor Force Data for States and Major Labor Areas, U.S. Department of Labor, 1975.

As is evident unemployment in the United States, Montana, and other states has been extraordinarily high during the 1974-75 recession. There have been some changes in the Montana unemployment rate in recent months. These changes are depicted in illustration 2.6. However, most of the improvement is seasonal in nature while some may possibly be attributed to improved economic conditions.

Illustration 2.6
MONTANA UNEMPLOYMENT RATES
JANUARY 1974 THROUGH OCTOBER 1976



Source: Research and Analysis Section, Employment Security Division

Finally, the Montana UI program has undergone the most extreme test it has ever faced, as discussed in Chapter III. This has also happened in other states. Some of these states have undertaken measures to restore the program to a sound financial and operating basis.

Inasmuch as the crisis has been nationwide, the Congress recently enacted legislation (H.R. 10210, the Unemployment Compensation Amendments of 1976) which addresses some of the topics discussed in the ensuing pages of this report. The changes mandated by the federal legislation affect the UI systems in Montana and other states in that the state UI systems will have to be changed to conform to the federal requirements. These changes are necessary in order for employers in the respective states to continue to be eligible for the federal UI tax credit. The major changes by the federal legislation which affect topics in this report are as follows:

1. Extension of the taxable wage base from $4,200 to $6,000 effective--January 1, 1978.

2. Denial of UI benefits to retirees whose pension benefits exceed the weekly UI benefit amount--effective October 1, 1979.

3. Allow states to deny UI benefits to nonprofessional employees based on educational institution service for periods between school terms--effective January 1, 1978.

4. Increase in the Federal Unemployment Tax Act (FUTA) tax rate from .5 percent to .7 percent--effective January 1, 1977.

As previously mentioned, Montana will have to change its UI system to meet the federal requirements or risk losing the federal tax credit for Montana employers. We have considered the effect of the new federal legislation in formulating our conclusions and recommendations in the chapters which follow.

The remaining chapters address areas where changes should be made in the Montana UI program to improve the program and restore it to a sound condition.

Chapter III

THE TAX SYSTEM THAT FINANCES UNEMPLOYMENT INSURANCE

The unemployment insurance program in the United States basically operates on the basis of money provided by the taxation of employers. In all except three states--Alabama, Alaska and New Jersey--employers pay all the taxes which finance the state unemployment insurance benefits and the federal and state administrative costs of the unemployment insurance program. During calendar year 1974, the latest year for which uniform data is compiled, employers in the United States paid UI taxes of $5.2 billion. During the same period, employers in Montana paid $10.4 million in UI taxes. Illustration 3.1 depicts UI tax statistics in Montana during the past 35 years.

Illustration 3.1
COVERED EMPLOYERS IN MONTANA AND UI TAXES PAID

Calendar Year	Number of Covered Employers	UI Taxes Paid by Employers To ESD	UI Taxes Paid by Employers To F.U.T.A.
1940	*	$ 2,777,000	$ 303,222
1941		2,966,000	315,512
1942		3,305,000	374,232
1943		3,583,000	386,406
1944		3,523,000	390,402
1945		3,545,000	421,746
1946		4,068,000	478,368
1947	11,024	3,699,000	580,683
1948	12,032	3,834,000	665,811
1949	12,707	4,236,000	702,297
1950	13,377	4,456,000	743,958
1951	14,382	5,057,000	802,914
1952	14,146	5,345,000	841,164
1953	14,175	3,661,000	852,807
1954	14,588	3,510,000	866,202
1955	14,993	3,694,000	912,588
1956	15,410	4,094,000	978,288
1957	15,788	3,863,000	946,980
1958	16,257	3,435,000	907,056
1959	16,207	4,036,000	950,235
1960	16,024	7,008,000	954,603
1961	15,991	7,554,000	1,278,448
1962	16,596	5,364,000	1,350,172
1963	15,860	5,220,000	1,365,028
1964	16,476	5,196,000	1,365,660
1965	15,918	5,583,000	1,440,728
1966	15,898	5,547,000	1,475,268
1967	15,794	5,658,000	1,494,672
1968	15,869	5,960,000	1,539,544
1969	15,500	6,277,000	1,584,208
1970	15,776	6,722,000	2,023,915
1971	15,733	6,954,000	2,111,005
1972	15,945	8,974,000	2,858,010
1973	17,214	10,224,000	3,081,825
1974	17,518	10,400,000	3,294,105
1975	18,221	12,788,000	3,619,250

*Data not readily available.

Source: Compiled by Office of the Legislative Auditor from ESD statistical log book.

THE UNEMPLOYMENT INSURANCE TAX

The tax features of the UI program originated in Title IX of the UI provisions of the Federal Social Security Act of 1935. The federal law provided for a payroll tax to be paid to the federal government by all covered employers. Initially, the tax was 3 percent of the total gross wages paid by covered employers to employees. Inasmuch as one of the basic purposes of the federal legislation was to create a federal-state system of unemployment insurance, the federal legislation provided for a tax credit. In order to attain the tax credit, states had to establish a UI program which met the federal guidelines. If the state established an acceptable program, employers in the state received a 2.7 percent credit against their federal tax liability, and the state became entitled to federal grants to cover all the necessary costs of administering the state program. By June 30, 1937, all of the then 48 states, Hawaii, Alaska and the District of Columbia had approved UI laws. Montana's law was enacted in March 1937.

The fact that the federal law provided for a tax credit did not mean that employers paid a tax of less than 3 percent simply because the state UI system was approved. In fact, the federal law allowed states to levy a tax in either of two ways to finance the state UI benefits: states could levy a flat rate tax on employers of 2.7 percent of their gross payroll, or they could levy a variable tax rate based upon other criteria such as the employment history of the employer. This is referred to as "experience rating."

Initially, Montana's UI system did not use experience rating--employers paid a UI payroll tax of 3.0 percent: 2.7 percent was a flat rate tax collected by the state and 0.3 percent was collected by the federal government. In 1946, Montana changed to a variable tax rate

ranging from 1.0 percent to 2.7 percent, based upon individual employer experience.

Over the years, various aspects of the state and federal UI tax changed. Periodic federal legislation raised the federal tax rate from 3.0 percent of total wages in 1935 to 3.1 percent in 1961, and 3.2 percent in 1970. Throughout this period and at the present, the allowable tax credit remained at 2.7 percent. While initially the UI tax applied to all taxable wages, in 1939 federal legislation established a tax base of $3,000, i.e., the UI tax was assessed against the first $3,000 in wages paid by employers to employees during a calendar year--the wages over $3,000 were exempt from taxation. Similarly, Montana legislation also established a wage tax base or limit of $3,000 in 1941.

The UI wage tax base remained at $3,000 until 1972 at which time both the federal and state UI wage tax base was raised to $4,200. Consequently in 1972, the MAXIMUM UI tax was 3.6 percent (federal, .5 percent and state, 3.1 percent) of the first $4,200 paid to a worker within a calendar year. Currently, the UI tax for Montana employers is as follows:

	Wage	Rate
Federal	$4,200	.5%
State	4,800	3.1% (max.)

All of the UI taxes collected from employers are deposited in the U.S. Treasury. Part of the UI tax (0.5 percent) is collected directly from employers by the federal government. This portion of the UI tax is generally known as the F.U.T.A. tax or Federal Unemployment Tax Act tax. The UI tax collected by the federal government is deposited by the federal government to the Employment Security Administration account--

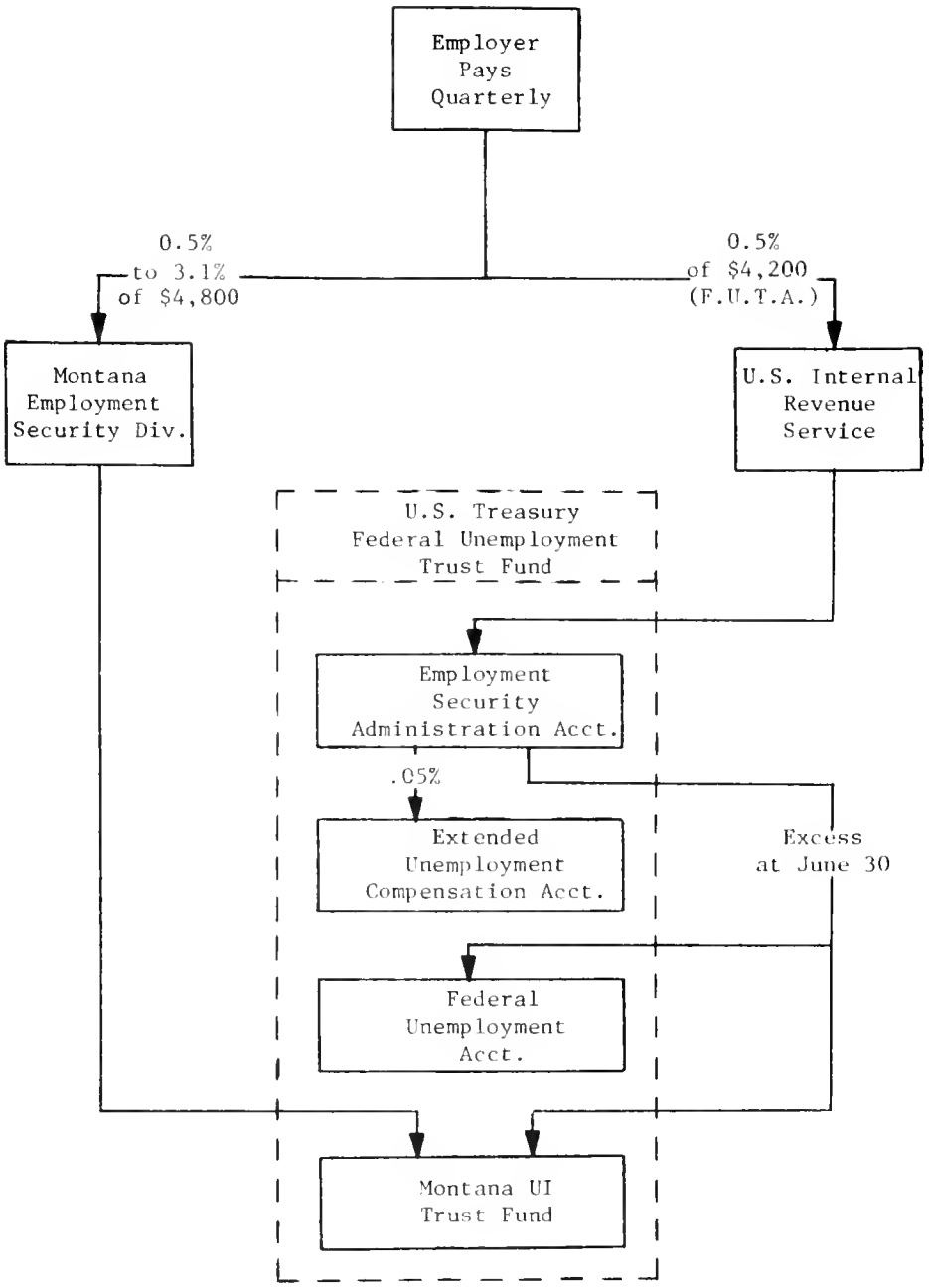
one of three separate accounts in the Federal Unemployment Trust Fund of the U.S. Treasury. Congress appropriates money annually from the administration account to pay the federal and state costs of administering the overall employment security program (including the UI program). Consequently, the states (Montana included) have not had to collect any additional tax from employers or make any appropriations from general state revenues for administration of the program.

Part of the UI tax is also collected directly from employers by the states. This portion of the UI tax is deposited directly by the states in the U.S. Treasury--into a special trust account for each state. In most states, the maximum standard UI tax is 2.7 percent of the first $4,200 in wages--the maximum tax credit allowed by the federal law against the federal UI tax. Nine states, including Montana, have a standard maximum UI tax rate in excess of 2.7 percent (New Jersey, 2.8 percent; Puerto Rico, 2.9 percent; Hawaii, Ohio and Nevada, 3.0 percent; MONTANA, 3.1 percent; and North Dakota, 4.2 percent). In Montana, the actual UI tax rate paid by employers ranges from 0.5 percent to 3.1 percent, depending upon employer experience. New employers in Montana pay a UI tax of 3.1 percent for three years to establish an employment history.

Aside from differences in the amount of UI tax collected by the federal and state governments, the primary difference between the federal and state UI tax is in its use: the tax collected by the federal government is primarily used to pay state and federal administrative costs; the tax collected by states is used to pay UI benefits. The payment of benefits is discussed more extensively in Chapter IV of this report. The collection and allocation of UI taxes in Montana are depicted

in a general manner by illustration 3.2. Interestingly, while Congress set up a system to overflow excess funds in the Federal Unemployment Account back to individual state's funds, in actuality this overflow seldom occurs and its amount is insignificant.

Illustration 3.2
DISTRIBUTION OF UI TAX ON EMPLOYERS IN MONTANA
AS OF JULY 1, 1976



Source: Office of the Legislative Auditor

Although the UI tax set by the federal government is currently 3.2 percent of the first $4,200, both the tax rate and the wage base will change in the near future. Recent federal legislation (Unemployment Compensation Amendments of 1976 - H.R. 10210 discussed more completely at the conclusion of Chapter II) made numerous changes in the federal guidelines. With respect to the UI tax, the new federal legislation made two significant changes: increased the FUTA taxable wage base from $4,200 to $6,000 to be effective January 1, 1978, and increased the federal portion of the UI tax from 0.5 percent to 0.7 percent as of January 1, 1977. To the states, this means a raise in the total federal UI tax on employers from 3.2 percent to 3.4 percent with the same tax credit provision of 2.7 percent.

The changes in the federal law were prompted to a large part by economic problems faced by the UI system both on a national level and on a state-by-state basis. The major problems in Montana are addressed in the remainder of this chapter.

SOLVENCY OF MONTANA'S UNEMPLOYMENT INSURANCE TRUST FUND

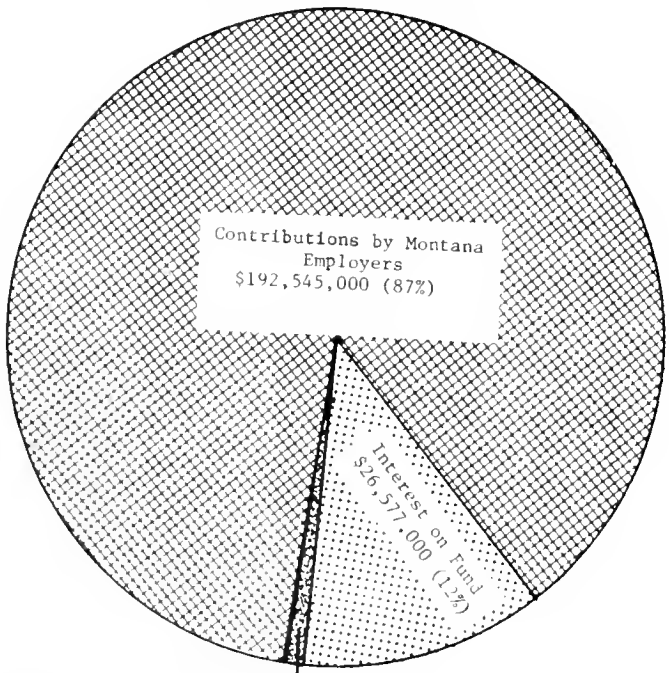
The money collected by Montana under the UI tax is deposited in the Montana unemployment trust fund account in the U.S. Treasury. The money in the trust fund account comes from several sources, although the most significant source by far is the UI tax as shown by illustration 3.3.

As previously described, the money derived by the state collection of UI taxes--paid into the state UI trust fund--is used to pay UI benefits. The amount of the state UI trust fund depends primarily upon two factors: (1) the revenue to the trust fund, and (2) the UI benefits paid out of the fund. These two factors are, in turn, variously dependent upon a multitude of other factors such as the individual UI tax rates and wage

bases, level and extent of UI benefits and general economic conditions in the business sector.

Hypothetically, in an insurance operation such as UI, rates are set and money collected over an extended period to pay current benefits and provide sufficient reserves for periods of losses. The rates charged are usually based upon actual experience. In the case of UI, the theory is no different except there are numerous external factors involved, including those described in the preceding paragraph. All of these factors combine to have an effect on the income, outgo and balance of the state UI trust funds.

Illustration 3.3
SOURCES OF REVENUES FOR MONTANA'S UNEMPLOYMENT INSURANCE TRUST FUND FROM INCEPTION TO JUNE 30, 1975

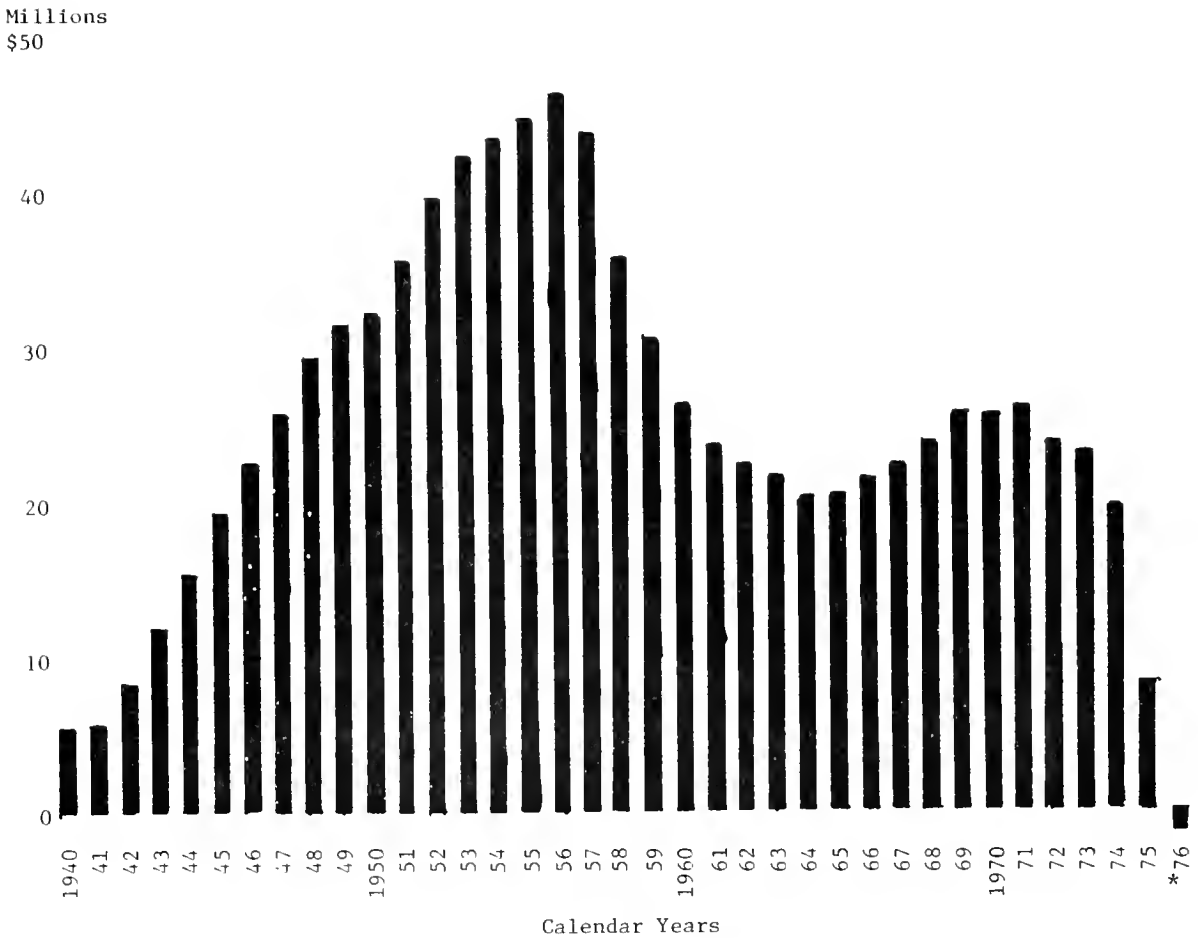


Penalty and Interest	$ 10,000
Voluntary Contribution	432,000
Title IX Funds	6,000
Temporary Compensation Fund	673,000
Extended Benefits Fund	655,000
Federal Supplementary Benefits Fund	406,000
Total Miscellaneous Sources	$2,182,000 (1%)

Source: Office of the Legislative Auditor from unpublished data at the Employment Security Division.

The history of Montana's UI trust fund balance shows a mixed trend from $4.7 million in 1937 to a high of $46.2 million in 1956 to a projected deficit of $1.1 million at December 31, 1976. The following graph depicts the trend of Montana's UI trust fund over the years.

Illustration 3.4
MONTANA'S UI TRUST FUND BALANCE
1940 - 1976
(as of December 31)



*Projected deficit balance at December 31, 1976.

Source: Office of the Legislative Auditor, from Statistical Log Book, Table A-1.

As the foregoing graph depicts, Montana's trust fund balance at the end of calendar year 1975 was very low--about $7 million. The seriousness of this low balance is underscored by the high levels of income and outgo activity--UI benefits in Montana paid out were about $5.8 million during the last calendar quarter of 1975 while UI tax revenue during the same period was only $2.4 million. Similarly, during the first calendar quarter of 1976, UI benefits paid out were $9.8 million while UI tax revenue during the same period was only $3.2 million. In April 1976 the Montana UI trust fund became insolvent--there were insufficient reserves and revenue to pay current UI benefits. Consequently, Montana began borrowing money from the Federal Unemployment Account in the U.S. Treasury. In March 1976 Montana's trust fund had been advanced $1.4 million and official predictions estimate this loan will be sufficient only through December 31, 1976. The division has requested an additional $2,283,000 from the Federal Unemployment Account to sustain the fund through January 31, 1977.

Montana was not alone in having a bankrupt UI trust fund. In fact, as of October 1, 1976, 21 states (including Montana) had UI trust funds which were insolvent to the point that borrowing from the Federal Unemployment Account was necessary and it anticipated that 24 states will be in this condition by the end of calendar year 1976. The federal government had advanced $3.1 billion from the Federal Unemployment Account to these 21 states. The making of these advances plus the federal extended and special benefit programs in turn bankrupted the Federal Unemployment Account which had to be bolstered by direct appropriation of over $1 billion in general revenues from the U.S. Treasury. The amounts borrowed by the 21 states as of August 15, 1976, are depicted in illustration 3.5.

Illustration 3.5
AMOUNTS BORROWED BY STATES
FROM FEDERAL UNEMPLOYMENT ACCOUNT
August 15, 1976

		In Millions Per CY					
	States	1972	1973	1974	1975	Through 8/15/76	Total
1.	Connecticut	$31.8	$21.7	$8.5	$190.2	$ 91.0	$343.2
2.	Washington		40.7	3.4	50.0	55.3	149.4
3.	Vermont			5.3	23.0	6.5	34.8
4.	New Jersey				352.2	145.0	497.2
5.	Rhode Island				45.8	20.0	65.8
6.	Massachusetts				140.0	125.0	265.0
7.	Michigan				326.0	245.0	571.0
8.	Puerto Rico				35.0	12.0	47.0
9.	Minnesota				47.0	76.0	123.0
10.	Maine				2.4	12.5	14.9
11.	Pennsylvania				173.8	255.8	429.6
12.	Delaware				6.5	7.0	13.5
13.	Dist. of Col.				7.0	22.6	29.6
14.	Alabama				10.0	20.0	30.0
15.	Illinois				68.8	307.0	375.8
16.	Arkansas					20.0	20.0
17.	Hawaii					22.5	22.5
18.	Nevada					7.6	7.6
19.	Oregon					18.5	18.5
20.	Maryland					36.1	36.1
21.	MONTANA					1.4	1.4
	Total	$31.8	$62.4	$17.2	$1,477.7	$1,506.8	$3,095.9

Source: Unpublished data, U.S. Department of Labor, Unemployment Insurance Service, Branch of State Tax Accounting and Controls

Borrowing from the federal account was unprecedented in the UI history of Montana. However, several other states--Alaska, Michigan and Pennsylvania during the 1958-59 recession, and Washington during the aerospace cutbacks in the late 1960's--previously borrowed UI money from the federal government.

The advances to states from the federal UI account are interest-free but repayment is required. Because of the magnitude of the problem being faced by the states who have borrowed from the federal fund--for example, New Jersey owes $497 million, federal legislation recently placed a

moratorium on repayment requirements until 1979. Repayment of loans from the federal fund is governed by the Social Security Act (42 USCA, Section 1321 et seq.) and the Internal Revenue Code (26 USCA, Section 3302(C)(3)) which provide two methods of repayment: voluntary repayment by the state or increases in the FUTA tax beginning January 1, 1979. If the loan has not been repaid in full by November 1, 1979, the current FUTA tax credit of 2.7 percent to Montana employers will be reduced by .3 percent--an increased FUTA tax of .3 percent for 1979. If the loan hasn't been paid off by November 1, 1980, the tax credit is reduced another .3 percent. This continues increasing yearly until the loan balance is zero. These federal laws also provide for additional increases, above the .3 percent per year, in 1980 and 1982 if the loan has not been repaid.

Accordingly, employers in Montana face a future period of heavy UI taxation which is necessary to (1) repay the federal advance; (2) pay current UI benefits; and (3) restore the solvency of Montana's UI trust fund. The important aspect of these problems is that all of these things have to be done simultaneously.

To accomplish this, ESD needs to resolve problems in five separate but interrelated areas by determining:

1. What the minimum UI trust fund level should be.
2. What the rate of recovery should be for the UI trust fund.
3. Whether the UI tax rate and/or tax base should be changed.
4. Whether experience rating is working properly.
5. Whether actuarial services are warranted.

The matters addressed in the following paragraphs may assist in the solution of the problems in these areas.

MINIMUM TRUST FUND LEVEL

As shown in illustration 3.4 on page 31, Montana's UI trust fund balance climbed steadily from the early 1940's to a peak in the mid 1950's, experienced a sharp decline in the balance through the mid 1960's with a slight recovery in the early 1970's, and declined to virtually nothing in the mid 1970's. It is obvious that it has been a sort of feast and famine experience. The high fund balance built up during the prosperous periods of the early 1950's enabled Montana's UI fund to survive the periodic economic recessions which followed in ensuing years. The fund balance was drastically affected during these recessionary periods--it dropped from over $46 million to less than $21 million in nine years--as UI benefits surpassed UI revenues. In fact, the balance never recovered.

Public officials generally agree that the economic recession currently being experienced is the worst since the Great Depression of the early 1930's. Most also generally agree that the current economic problems have resulted in the first UI test of the UI system. Not everyone agrees, however, that the system has passed the test--met and overcome the problems for which it was designed and established. In fact, Montana's UI trust fund failed to meet the ultimate test--to have a reserve sufficient to pay all benefits. The state has had to borrow additional money. And even if the fund balance had been larger, it would have merely been a matter of time before it was depleted.

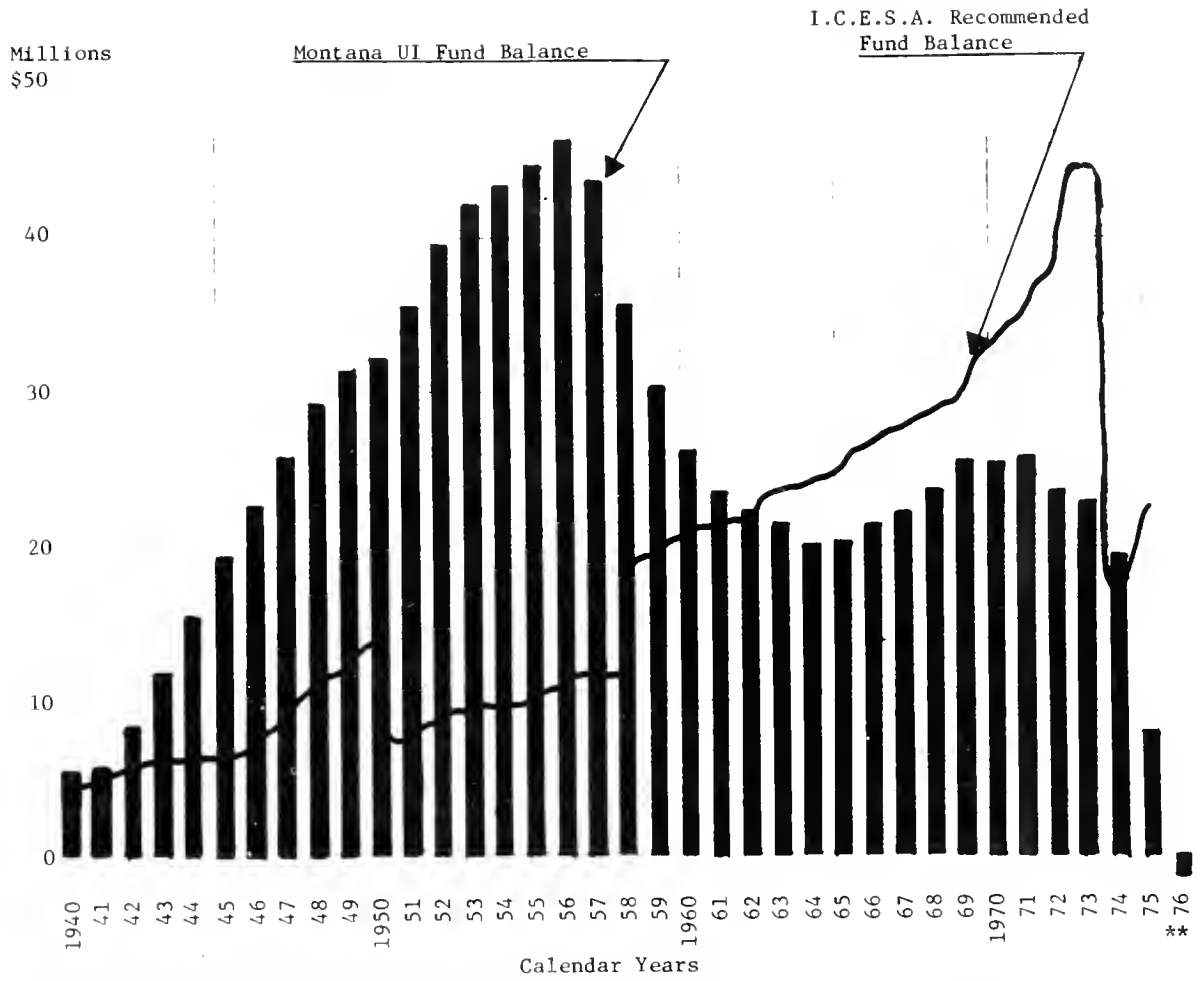
There are several ways to measure the adequacy and solvency of the UI trust funds. One of the measures most widely accepted is the high cost multiple reserve.

The high cost multiple reserve measure has been advocated since 1952 by the Interstate Conference of Employment Security Agencies (I.C.E.S.A.)--an association of UI agencies such as ESD. In a report prepared in October 1953, I.C.E.S.A. advocated the most effective measure of a trust fund solvency as one that evaluates the fund balance as a multiple of the state's average annual benefit cost.[17] Since that time I.C.E.S.A. modified the measure to the extent that the minimum reserve (or minimum fund balance) of a state UI trust fund should be one and one-half times the highest cost year--in terms of UI benefits paid out--as a percent of total annual wages during the highest cost year times the current year. This measure in mathematical formula is:

$$\frac{1\frac{1}{2} \times \text{high cost year}}{\text{wages paid during high cost year}} \times \text{current year wages} = \text{minimum adequacy level}$$

In other words, the UI fund balance should fluctuate from year to year in direct relationship to total wages paid by employers each year. As total annual wages decrease, the UI fund should decrease; as total wages increase (as has been the case in recent years) the fund balance should increase. Consequently, one would expect to see a trend of gradual increase in the UI fund balance. The following illustration depicts in absolute dollars rather than real dollars the trend of Montana's UI trust fund in relation to I.C.E.S.A. criteria.

Illustration 3.6
MONTANA UI TRUST FUND BALANCE COMPARED
TO I.C.E.S.A. MINIMUM ADEQUATE FUND LEVEL*
(as of December 31)



*I.C.E.S.A. refers to the Interstate Conference of Employment Security Administrators.
**Projected deficit balance at December 1, 1976.

Source: Office of the Legislative Auditor from Statistical Log Book, Table A-1.

The preceding graph illustrates one significant problem indicative of a feast and famine experience. While the I.C.E.S.A. criteria suggested a low fund balance, around $11 million in 1956, Montana's trust fund balance was in excess of $46 million. In contrast, while the I.C.E.S.A.

criteria suggested a high fund balance, around $45 million in 1973, Montana's trust fund balance was only $23 million. There is no doubt that had Montana's UI trust fund balance been based upon the I.C.E.S.A. criteria, the current insolvency of the trust fund would have been averted or at least delayed longer--possibly into the period of economic recovery from the recession.

While the I.C.E.S.A. criteria shows that the trend of Montana's trust fund balance was the opposite of what it should have been, the criteria itself has deficiencies which inhibit the responsiveness of the UI trust fund. Since the primary objective of the trust fund is to provide a reserve for lean years--recessionary years are lean years--the criteria which fixes the fund balance should always in some way incorporate the potential losses (benefits) during a recession. The I.C.E.S.A. criteria does not always do this. It always uses the highest cost year on record. Before 1973 this was 1958--a recessionary year. But benefits paid during the winter of 1973-74 were more than the $13 million paid in 1958, and therefore 1973 replaced 1958 as the high cost year. However, 1973 was not a recessionary year and therefore does not reflect recessionary experience.

Any criteria for minimum adequate fund level should not be triggered to a lower level unless the potential drain on the fund decreases. In fact, the potential drain on the trust fund was increasing at this time due to higher benefit costs. When the criteria falsely triggers down, as it did in 1973, it gives a false impression of fund adequacy. Obviously the fund balance would not have been adequate since in 1974 the actual fund balance exceeded the I.C.E.S.A. suggested fund balance but the fund still became insolvent.

The I.C.E.S.A. criteria is also deficient from the standpoint that it does not incorporate probability factors. That is, the fund balance levels suggested by the I.C.E.S.A. criteria are primarily based upon the experience of a single year--the highest benefit year. As a result, the criteria does not consider the probability of such experience recurring nor the probability of more severe experiences occurring, e.g., a recession. Had the probability of such occurrences been a part of the criteria used to set the trust fund balances, the most recent heavy benefit costs and possible insolvency of the trust fund could have been more distinctly predicted and provided for much earlier. As it was, in June 1975 ESD predicted potential insolvency. In November 1975 they predicted that the fund would be insolvent by April 1976. However, various ESD officials told us they were concerned about possible insolvency in 1974 and that the possibilities of insolvency had been discussed with appropriate elements of the 1975 legislature in conjunction with ESD legislation considered and enacted in 1975. They characterized the 1975 changes as being what was necessary but too late.

In retrospect, what happened does not make sense. Total wages were rising, benefit costs were rising, yet the UI tax rates were remaining basically the same and the I.C.E.S.A. suggested trust fund balance and actual trust fund balance were going down when they should have been going up. This was caused by the inability of the present system to consider the probability of a heavy recession combined with its inability to distinguish between the effects of inflation on one hand and an impending recession on the other.

Finally, there are fail-safe features which could be used to protect the balances of the trust fund. A minimum fund balance level could be

established on the basis of benefit costs predicted on the basis of probable experience during a period of time at a selected rate of unemployment. For example, this could be a minimum trust fund balance based upon the benefits that would be paid over an 18-month period at an unemployment rate of 8 percent--the rate in 1958, the highest unemployment rate on record in Montana. In this regard, the original drafts of the legislation underlying the national UI program recommended that reduced UI taxes be prohibited unless the trust fund balance exceeded benefit payments in the preceding year and that a UI tax of less than 1.8 percent of wages be prohibited unless the trust fund balance exceeded twice the preceding year's benefit costs. Twenty-seven of the original 38 states with a variable UI tax rate followed the original recommendation.[18] Montana did not follow the recommendations, but rather collected UI taxes at a fixed rate until 1947 when a variable tax rate was adopted. This is the reason why Montana's trust fund balance initially grew so dramatically as depicted by illustration 3.6 on page 37.

The Montana UI trust fund balance is not based upon I.C.E.S.A. criteria. Rather, it is based upon a system of triggers: a high fund balance triggers lower taxes; a low fund balance triggers higher taxes. The trigger levels are based upon criteria advocated by ESD and enacted by the legislature (Section 87-109, R.C.M. 1947). For example, when the trust fund balance is 2.5 percent or more of total wages, the UI tax rate ranges from 0.5 percent to 3.1 percent. On the other hand, if the fund balance drops below one percent of total wages, there is no tax range and all employers pay a tax rate of 3.1 percent. Since a rate of fund balance to total wages of 2.5 percent triggers the lowest taxes (as described above), it is in essence the official measure of the adequacy

of Montana's trust fund. Unfortunately, a trust fund balance of this size would have been insufficient to cover benefit costs during six of the last 40 years and, in fact, the UI taxes collected under the schedule (0.5 to 3.1) would not have been sufficient to pay benefit costs during an average year.

Several other states have undertaken measures or innovations to facilitate the adequacy of their fund balances. Oregon measures the adequacy of its UI trust fund balance based upon whichever results in the highest balance--the I.C.E.S.A. criteria or the amount of benefits which would be paid during a year with unemployment at a level of 7 percent.

Hawaii studied alternative measures of fund adequacy and developed a probability model which projected fund balance levels large enough to pay benefits at various levels of unemployment even some of which had less than 5 chances in 100 of occurring. With this type of information, a fund balance can be set at levels for which the potential exposure to drain and depletion is known. In order to demonstrate the applicability of the probability model, Hawaii used its model to assess the trust fund adequacy in six other states (Illinois, Indiana, Michigan, Ohio, Pennsylvania and Texas). They concluded that the model was a good measure of the trust fund adequacy--better than the high cost-multiple reserve method.

In summary, Montana has not determined what trust fund balance is necessary to accomplish the objectives of the UI program. The fund balance in the past has basically been self-determined rather than having been predetermined. In order to have a meaningful insurance function which accomplishes what an insurance function is supposed to--

establish a reserve to meet potential losses--Montana needs to determine what minimum trust fund balance is necessary for the short and long-range. This could be accomplished by basing the fund balance upon factors which recognize the different effects of inflationary and recessionary costs on the trust fund and the probability of past experiences recurring.

RECOMMENDATION

We recommend that the division institute a methodical and actuarially-sound means of forecasting the minimum trust fund balance.

RATE OF TRUST FUND RECOVERY

Determining what the UI trust fund balances should be is only the first step in resolving the problems facing the UI program in Montana. The division must also determine what the rate of recovery should be to replenish the trust fund.

Montana's UI trust fund was projected to be insolvent, with a fund balance of $287,000 and debt of $1.4 million on December 31, 1976. An additional $2,283,000 has been requested from the Federal Unemployment Compensation Loan Fund to bolster the fund through January 31, 1977. Faced with this prospect and the current level of benefit costs, as well as the current level of UI taxes, the division predicts that it could be several years before the trust fund balance is adequate to cover potential benefit costs and the federal debt.

It is important that the trust fund be replenished as soon as practicable. It is not satisfactory to merely let matters take their natural course. The rate of unemployment is still high, economic conditions are still in the process of recovery, and employers in the state are already faced with the highest UI taxes in history. Nevertheless, the UI program

needs to be brought back to a solvent status and the trust fund needs to be restored.

In order to provide for the recovery of solvency and restoration of the trust fund in the most optimum manner, the division needs to devise a deliberate plan for recovery. Once the division determines the fund balance necessary for an adequate reserve, it should formulate the measures and interim goals to achieve this fund balance.

It is unreasonable to expect that recovery of solvency and restoration of the fund balance will be accomplished within a short time frame. But it is not unreasonable to expect the division to know approximately what level of recovery is necessary and expected at various stages of the recovery process--on a month-to-month or calendar quarter basis.

In order to accomplish an optimum recovery considering current economic conditions, the division must establish a step-by-step process. This process should have specific interim targets or goals set in terms of the amount of the UI tax revenue which needs to be collected to (1) pay current benefit costs, and (2) generate a contribution towards restoration of the trust fund. Once these interim targets or goals are established, the division must formulate an accelerated tax structure to produce the revenue necessary to meet the interim targets or goals and, eventually, the minimum trust fund balance. While an accelerated tax schedule is essential to the accomplishment of the goals, the accelerated level of taxes must be gradual to prevent a worsening of current economic conditions. Nevertheless, additional UI taxes must be collected.

Upon formulation of its targets, goals, overall plan and accelerated tax schedule for recovery of solvency and restoration of the trust fund, the division should present the plan to the legislature to enable

legislation necessary to revise the current UI tax schedule in Section 87-109, R.C.M. 1947.

RECOMMENDATION

We recommend that the division formulate a plan of specific interim targets and goals and a revised UI tax structure including any appropriate legislation to provide for a gradual and reasonable restoration of the trust fund.

LEVEL OF UNEMPLOYMENT INSURANCE TAXES

As previously discussed, the UI program in Montana and in all except three states (Alabama, Alaska and New Jersey) operates on the basis of a tax on covered employers only. The UI tax in Montana is an employer tax. It is based on the employer's payroll. The amount of UI tax collected depends upon two factors--the tax rate and the wage base. The tax rate is usually expressed as a percentage, e.g., 3.1 percent. The wage base is the portion of the payroll taxed, for example, the first $3,000, $4,200, $4,800, or $6,000. In other words, the employer pays a tax of 3.1 percent of the first $4,200 earned by each employee. Both the tax rate and the wage base vary from state to state and are either specifically prescribed by state law or generally prescribed by a formula which is set out in state law.

Both the UI tax rate and wage base in Montana are specifically prescribed by state law. The UI tax rate ranges from 0.5 percent to 3.1 percent depending upon employer employment history and the status or level of the trust fund. The UI wage base ranges from $4,200 to $4,800, also depending upon the status of the trust fund or the federal wage base, whichever is higher. Montana's wage base went to $4,800 on April 1,

1975, and all covered employers will pay the maximum tax of 3.1 percent on January 1, 1977. As previously mentioned, the federal wage base was recently increased (by H.R. 10210--the Federal Unemployment Compensation Amendments of 1976) from $4,200 to $6,000. This increase becomes effective on January 1, 1978. Consequently, Montana's wage base will also increase to $6,000 on January 1, 1978, and the tax rate in Montana will thereafter be levied against the first $6,000 paid to each employee by covered employers in the state.

Essentially, the level of UI taxes involves two or three alternatives. UI taxes on employers can be raised and additional UI revenue collected by (1) raising the wage base; (2) raising the tax rate, or (3) raising both the wage base and the tax rate. There are advantages and disadvantages with each alternative.

The Wage Base

When the UI laws were initially enacted, virtually all of the wages paid by covered employers were subject to the UI tax. The wage base was, in effect, 100 percent of the wages. In 1939, the taxable wage base was fixed by the Congress at $3,000 for both the federal UI program and the Social Security program. Over the years, the wage base for the Social Security program was raised to its current level of $15,300. The UI wage base, however, did not change as dramatically. The federal UI wage base remained at $3,000 until 1970. In 1970 the Congress raised it to $4,200 at which level it will remain until January 1, 1978, when it will increase to $6,000.

There are basically two problems involved with the UI wage base, both nationally and in Montana: the erosion of the wage base and the relationship of the wage base to benefits.

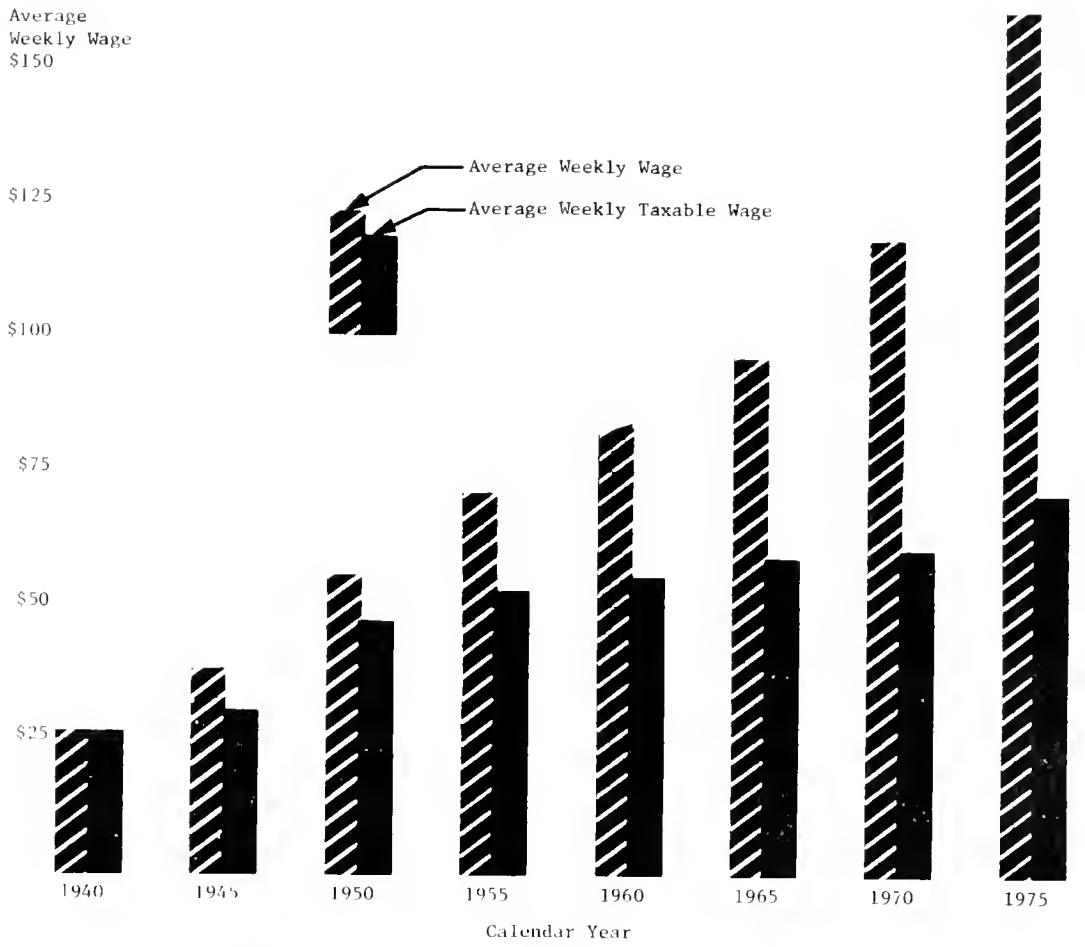
Erosion of the Wage Base

Erosion pertains to the fact that wherein once virtually all of the wages paid by covered employers were subject to the UI tax, now only about 50 percent of the wages are subject to the UI tax. As previously mentioned, the federal UI wage base was initially set at $3,000 in 1939. In 1940, the $3,000 wage base encompassed about 93 percent of the wages paid by covered employers. However, since 1940, the wage base has steadily eroded to a point where almost one-half of the wages paid by covered employers are not subject to the UI tax. This is because wages rose over the years while the wage base remained the same. The increase in the federal UI wage base to $4,200 in 1972 increased the coverage of the wage base nationally to about 52 percent of the covered wages, but by 1973, because of increased wages, the wage base again represented less than 50 percent of the covered wages--49.7 percent. At the time the $3,000 wage base was set, the national average weekly wage in covered employment was $26.16. In contrast the national average weekly wage in 1973 was $163.97, more than a six-fold increase. If the wage base had kept pace with the changes in wage levels over the years, it would be approximately $18,000 now. In 1939, the average annual wage nationally in covered employment was about $1,400--while the wage base was $3,000. Congress established a wage base which was more than twice the average annual wage to underwrite the costs of the UI program.

The experience in Montana has been really no different than that nationally as described above. Initially, in 1938, the average weekly wage in Montana was $24.84 and 100 percent of it was subject to the UI tax. In contrast, in 1975 the average weekly wage in Montana was $161.98 of which only $71.41 or about 44 percent was subject to the UI tax. The

following chart demonstrates the extent to which the wage base has been eroded in Montana.

Illustration 3.7
RELATIONSHIP OF AVERAGE WEEKLY WAGE IN MONTANA
TO THE AVERAGE WEEKLY TAXABLE WAGE IN MONTANA



Source: Statistical Log Book, Table A-6, Research and Analysis Section, Employment Security Division

While the preceding illustration depicts the trend on an average weekly wage basis the same effect exists on an annual basis. In 1975 the annual average wage in covered employment in Montana was $8,422.96, while the wage base is $4,800 or about 57 percent.

Erosion of the wage base has several adverse effects. Foremost, it results in insufficient UI tax revenue in comparison to total wages. This is particularly adverse in view of the fact that total wages comprise the basis for benefits. This aspect is discussed more fully in succeeding paragraphs. Erosion also has an adverse effect from the standpoint that studies have found that a wage base which is less than 50 percent of the average annual wage induces employers to cause unemployment. Dr. Frank Brechling of Northwestern University found in a study for the U.S. Department of Labor that the incentive for a firm to reduce turnover of its employees is greatest when the wage base is one-half or more of the average annual wage.[19] Similarly, recent research by the Public Research Institute and Dr. Joseph Becker of Georgetown University substantiate the favorable economic incentives of a wage base in excess of 50 percent of the average annual wage. Dr. Becker found many examples of where large firms saved money on one hand, or lost it on the other, by considering the UI tax incentives or ignoring them in their labor decisions.[20] The favorable effect is illustrated by a recent study of the Public Research Institute for the U.S. Department of Labor. The study found that "Because reductions in labor turnover reduce the firm's taxable payroll, changes in the taxable wage base can influence turnover and hence unemployment." The study used a simple example to illustrate the effect:

> For example, consider a case where the taxable wage base is $4,200 per year while the actual wage is $10,000 per year. If a firm hires one worker for the first six

> months of the year and replaces him with another for the second six months, its taxable payroll is $8,400 ($4,200 due to each of the two separate workers). If, however, the first worker were kept for the entire year, the taxable payroll would be only $4,200. Thus the firm can halve its taxable payroll, and its tax bill ***.

The Public Research Institute study concluded, "*** that the taxable wage base should be at least one-half annual wages but less than total wage."[21] As previously stated, the wage base in Montana was about 57 percent of average annual wages in calendar year 1975 and will decrease to about 50 percent of average annual wages by January 1, 1977. These low percentages lie at the bottom end of the recommended range, and any further decrease in the "real" tax base will not provide the incentives described by the preceding studies.

Finally, the lower the wage base, the larger the increase in UI tax rate must be in order to increase UI tax revenues. A larger base allows for smaller increases in tax rates, thereby avoiding the need for unrealistically high tax rates when unemployment is high and by reducing the complexity of legislative changes necessary to increase UI tax revenues.

The information presented above strongly points to an increase in Montana's wage base from its present level of about 53 percent of the average annual wage. A large number of states currently have wage bases in excess of Montana's current level of $4,800 as shown in illustration 3.8. This conclusion was also reached in a study of wage bases by the Upjohn Institute for Employment Research which found that "*** a taxing system which is based on employers' payrolls should levy its tax on a substantial portion of those payrolls each year rather than on a constantly diminishing portion of them."[22]

Illustration 3.8
STATES WITH TAXABLE WAGE BASE IN EXCESS OF $4,800

	State	Wage Base
1.	Alaska	$10,000
2.	Arizona	6,000
3.	Arkansas	6,000
4.	California	7,000
5.	Connecticut	6,000
6.	Georgia	6,000
7.	Hawaii	7,800
8.	Idaho	8,400
9.	Iowa	6,000
10.	Michigan	5,400
11.	Nevada	6,500
12.	New Jersey	5,400
13.	Oregon	8,000
14.	Utah	6,000
15.	Washington	7,800
16.	Wisconsin	6,000

Note: All of the states listed above currently have a wage base in excess of $4,800. In some cases, higher wage bases take effect January 1, 1977. The wage bases shown in the table are wage bases which will be effective on that date.

Source: Employment Security Division data.

In addition to having a wage base in excess of Montana's, six of the preceding states use some form of "escalating wage base." An escalating wage base changes as the average covered wage changes in contrast to a fixed wage base (which Montana has) which does not change in response to changes in the average weekly wage. As shown in illustration 3.7, Montana's wage base remained fairly static over the years even though wages rose substantially.

In 1964, Hawaii adopted the first escalating wage base. Since then several states have adopted a variation of the escalating wage base as follows:

Illustration 3.9
STATES USING AN ESCALATING WAGE BASE

	State	Base
1.	Hawaii	90% of average annual wage for prior fiscal year
2.	Idaho	100% of the average annual wage 2 years prior
3.	Nevada	66 2/3% of average annual wage, preceding calendar year
4.	New Jersey	28 x average weekly wage
5.	North Dakota	70% of State Annual Wage*
6.	Oregon	80% of average annual wage
7.	Utah	100% of the average annual wage 2 years prior
8.	Washington	up to 75% of average annual wage*

*Triggered when trust fund reaches a specified level

Source: Hearings before the subcommittee on unemployment compensation of the Committee on Wage and Means, House of Representatives, July 1975, p. 139; correspondence with other state UI divisions; and Montana Employment Security Division.

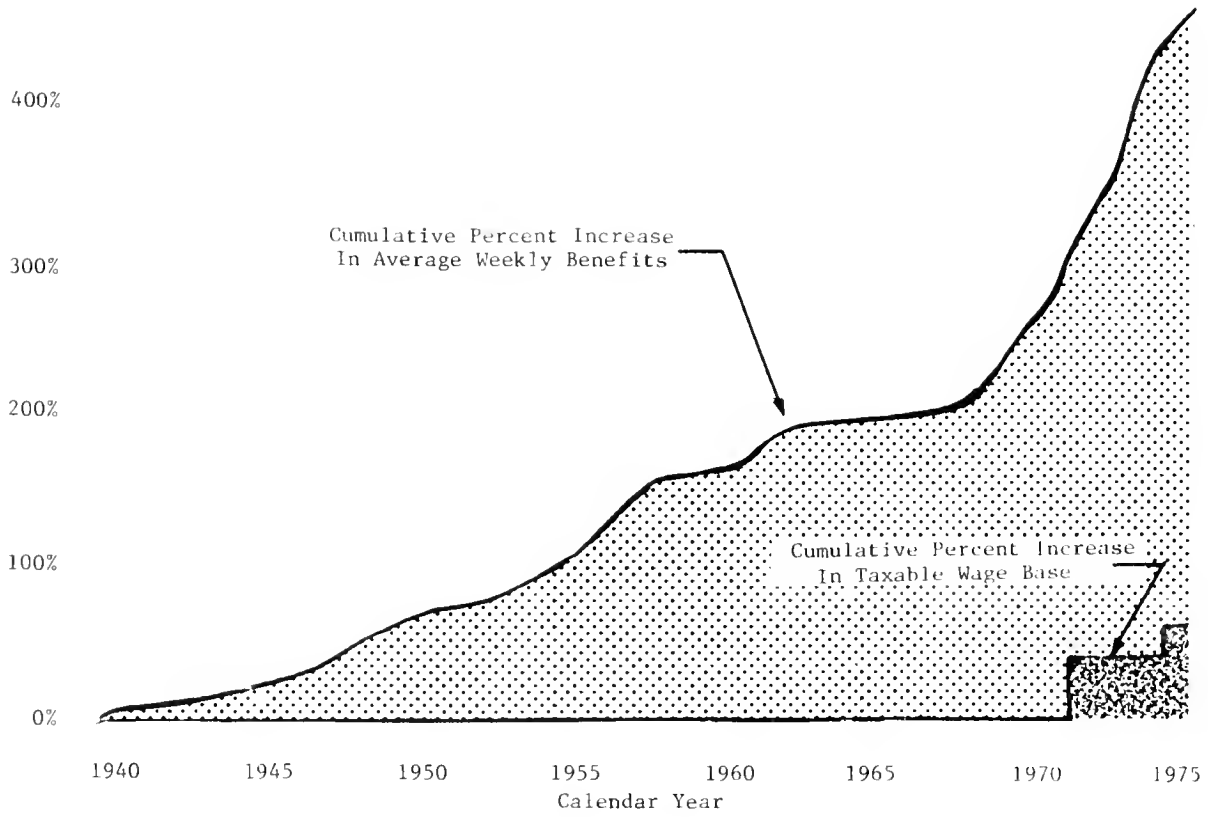
An escalating wage base is more responsive and flexible than a fixed wage base such as is used in Montana: it results in changes in the wage base whenever the average wage changes. This is important because the wage base is the base against which the UI tax is levied to pay UI benefits--which are directly based upon average wages. Since the wage base comprises the basis for financing benefits it would be logical to calculate the wage base in the same manner as benefits. This would keep the UI wage base in greater consonance with benefits.

Relationship to Benefits

Just as the UI wage base has not kept pace with wages, it has also not kept pace with UI benefits. UI benefits in Montana are based upon a percentage of the average annual wage. Montana law (Section 87-103, R.C.M. 1947,) specifies that the maximum weekly UI benefit is 60 percent of the average weekly wage. Consequently, the maximum weekly benefit increases in direct proportion to increases in the average weekly wage.

In Montana, as wages go up, benefits also go up, yet the wage base--which finances the benefits--remains the same. This is illustrated by the fact that the wage base in Montana increased only 60 percent between 1940 (3,000) and 1975 (4,800), while during the same period, average weekly benefit amounts have risen from $10.89 to $58.84, or 439 percent. This trend is also depicted by the following graph which shows the percent change over the years in the wage base as compared to UI benefits.

Illustration 3.10
CHANGES IN THE MONTANA WAGE BASE AS COMPARED
TO CHANGES IN UI BENEFITS IN MONTANA



Source: Office of the Legislative Auditor from Statistical Log Book, Table A-6.

It is obvious that the wage base has not kept pace with benefits. This resulted in a gradual depletion of the trust fund over the last decade and the Legislature has had to adjust the UI tax system several times in recent years to compensate for expanded benefits and inflation; yet the UI trust fund declined almost steadily since 1956. (See illustration 3.4 on page 31.)

An escalating wage base fixed at an appropriate percentage of the average annual wages in covered employment would have been conducive to greater solvency of the trust fund. Inasmuch as the wage base would have been directly correlated to average annual wages--which are, in turn, directly correlated to the level of benefits--the wage base would have been indirectly correlated to benefits. Such a correlation would have resulted in an increase in the wage base as benefits increased, thereby generating additional UI tax revenues to pay the increased benefits. This may not have totally averted the insolvency of the trust fund, but it would have most certainly reduced the impact of inflation and expanded benefits.

As depicted in illustration 3.9 on page 51, several states have adopted a flexible or escalating wage base. In some of these states the degree of escalation is related in some manner to the solvency status of the trust fund. In North Dakota, for example, the wage base is the same as the federal UI wage base unless the trust fund falls below 1½ times the highest amount of benefits paid in any year at which time the wage base automatically rises to 70 percent of the state's average annual wage. Similarly, in Washington the wage base also depends upon the solvency of the trust fund. If the trust fund in Washington is less

than 4.5 percent of total annual payrolls, the wage base increases $600, but not in excess of 75 percent of the state's average annual wage for the second preceding calendar year.

The laws governing Montana's wage base (Section 87-109(d), R.C.M. 1947,) should be amended to incorporate a flexible or escalating wage base which is directly correlated to the average annual wage of covered workers, and thus indirectly correlated to the level of benefits. This could be accomplished by formulating a tax base based upon a percentage of the average annual wage of covered employment (such as those depicted in illustration 3.9 on page 51). Establishing the wage base in such a manner would automatically result in an increase whenever the average annual wage--hence, the maximum weekly benefit--increased. This would generate additional UI tax revenue to pay the higher benefit, and would alleviate the necessity of such changes waiting as much as two years for modification by the Legislature.

In order to facilitate a change from a fixed wage base to an escalating or flexible wage base, the division should:

1. analyze the current UI tax process to identify and evaluate the correlation between the current wage base and tax rates, benefits and the average annual wages of covered employment.
2. Determine the wage base as a percentage of average annual wages which, in concert with the appropriate tax rating, is necessary for Montana to generate the UI tax revenue necessary to (a) provide money for current benefits, (b) restore the solvency of the trust fund, and (3) maintain the future solvency of the trust fund.

3. Propose legislation to amend Section 87-109(d). R.C.M. 1947, to provide for a wage base which is based upon a suitable percentage of average annual wages covered by UI.

RECOMMENDATION

We recommend that legislation be enacted to establish a flexible wage base as a percentage of the average annual wage in covered employment.

The Tax Rate

As mentioned at the outset of this chapter, the federal legislation establishing the UI program in 1935 initially set a federal unemployment tax of 3.0 percent. As a means of inducing the states to establish UI programs, the federal legislation provided for a 90 percent or 2.7 percent (90 percent of 3.0 percent) offset or tax credit on the federal tax. This offset or credit on the federal UI tax was available to employers who paid an equivalent tax to state UI programs which met the federal guidelines. One requirement of the federal guidelines was that a flat rate tax of 2.7 percent of taxable wages be levied on all gross payrolls unless the state has an approved system of experience rating. With such a system of experience rating, states could levy a UI tax of less than 2.7 percent on employers whose employment experience warranted a lower tax.

Soon after the enactment of the federal legislation, all of the states had also enacted UI programs. Initially, the various states levied UI taxes to pay UI benefits at the rate of 2.7 percent of gross payrolls. However, this flat rate approach changed over the years as the states adopted various systems of experience rating. (Note: The

experience rating process is discussed in detail in the last section of this chapter.)

Initially, the tax rate in Montana was 2.7 percent of the total annual payroll of covered employers. In 1947 the flat tax rate in Montana was changed to an experience rating system by the Legislature. The new system set the tax rates at a range from 1.0 percent to 2.7 percent with increments of 0.5 percent between the two extremes, e.g., 1.0, 1.5, 2.0, etc. New employers--those with less than three years of employment history--were still required to pay a flat rate of 2.7 percent.

In 1953 the UI tax schedule was again revised by the Legislature. The lower limit of the tax range was lowered to 0.5 percent (in contrast to the previous 1.0 percent) and the increments between the ratio were changed to 0.2 percent, in contrast to the previous 0.5 percent.

Finally, in 1969 the Legislature again revised the UI tax schedule by raising the upper limits of the schedule to 3.1 percent. The current UI tax schedule in Montana, as enumerated in state law, specifies that covered employers will pay the state a UI tax of between 0.5 percent to 3.1 percent of the first $4,800 in covered wages in increments of 0.2 percent, e.g., 0.5, 0.7, 0.9, 1.1, etc. The amount of tax paid by each employer depends upon (1) his employment history, which categorizes him into one of 14 employer classes, and (2) upon the status of the trust fund. The status of the trust fund affects the employer tax as illustrated by the following:

Illustration 3.11

MONTANA EMPLOYER UI TAX RATES BASED UPON THE STATUS OF THE TRUST FUND

Employer Class	Trust Fund Balance as Percent of Total Wages						
	2.50% & Over	2.25 to 2.49%	2.00% 2.24%	1.75 to 1.99%	1.50 to 1.74%	1.25 to 1.49%	Less than 1%
	Tax Rate - in Percent						
1	.5	.7	.9	1.1	1.3	1.5	3.1
2	.7	.9	1.1	1.3	1.5	1.7	3.1
3	.9	1.1	1.3	1.5	1.7	1.9	3.1
4	1.1	1.3	1.5	1.7	1.9	2.1	3.1
5	1.3	1.5	1.7	1.9	2.1	2.3	3.1
6	1.5	1.7	1.9	2.1	2.3	2.5	3.1
7	1.7	1.9	2.1	2.3	2.5	2.7	3.1
8	1.9	2.1	2.3	2.5	2.7	2.9	3.1
9	2.1	2.3	2.5	2.7	2.9	3.1	3.1
10	2.3	2.5	2.7	2.9	3.1	3.1	3.1
11	2.5	2.7	2.9	3.1	3.1	3.1	3.1
12	2.7	2.9	3.1	3.1	3.1	3.1	3.1
13	2.9	3.1	3.1	3.1	3.1	3.1	3.1
14	3.1	3.1	3.1	3.1	3.1	3.1	3.1

Source: Section 87-109, R.C.M. 1947.

As can be seen in the preceding table, the solvency of the trust fund (depicted as a percentage of total wages) affects the tax rate paid by employers. Since the Montana trust fund had a balance below 1 percent of total annual covered wages in Montana for fiscal year 1976, virtually all employers (the exceptions being government and nonprofit employers) will begin paying the maximum rate, 3.1 percent, on January 1, 1977. As can be seen by the right-hand column in illustration 3.11, employers will continue to pay the maximum rate of 3.1 percent until the trust fund regains its solvency. As previously mentioned, ESD officials indicate that this could take several years. If this is true, all covered employers in Montana will be paying the maximum UI tax, 3.1 percent, for some time to come without the benefits of experience rating.

There is substantial evidence to indicate that the UI tax rate schedule has some major flaws. Those flaws are evidenced to a certain degree by the fact that the tax rates prescribed by law in the schedule were not adequate to maintain the solvency of the trust fund, or even to provide in recent years sufficient revenues to cover current benefit costs. The inability of the tax structure to accomplish this is demonstrated by the downward trend of the fund balance as shown in illustration 3.3 on page 30. To a certain degree, an inadequate wage base (as discussed in the preceding section of this chapter) is the cause of the insufficient revenues.

Flaws in the tax rate schedule are also evidenced by the fact that the tax rate schedule, as depicted by illustration 3.11 on page 57, does not specify any tax rates for the employer classes when the trust fund balance as a percent of total wages is between 1.0 percent and 1.25 percent. This was apparently a minor oversight in the formulation of the tax schedule which was enacted into law. The division assured us they would introduce legislation to alleviate the problem.

Second, the tax rate schedule does not specify any different tax rates when the trust fund balance as a percent of total wages surpasses 2.5 percent. This is also evident in illustration 3.11.

By prescribing the lowest rates at a trust fund balance level of 2.5 percent, the schedule is, in effect, acknowledging that a trust fund balance of 2.5 percent is an adequate reserve balance. Historically, the benefit cost to total wages ratio, surpassed this 2.5 percent mark in two recessions over the last forty years. Even using the I.C.E.S.A. measure of adequacy results in a ratio of 3 percent which is .5 percent above the level set by law. In retrospect, one would not expect the

lowest taxes to be levied until the trust fund reaches an adequate level. Nevertheless, the current tax schedule has the lowest taxes at a 2.5 percent trust fund level--a level which is substantially below the minimum level considered to be adequate for Montana.

The low level of the highest tax rates in the current tax rate schedule is also a problem. As shown in illustration 3.11, the highest tax rate is 3.1 percent. Having the highest tax rate at 3.1 percent results in a significant subsidization of some employers by other employers. Employers whose ex-employees draw benefits which exceed the tax paid by the employer at 3.1 percent--the highest rate--obviously do not pay as much in contributions as their ex-employees receive in benefits. The difference comes from the taxes paid by other employers. This is particularly true of the seasonal industries where unemployment claims are high. No matter how high the claims and benefits go, the employer still pays no more than the maximum tax rate--3.1 percent.

As of January 1, 1977, all experience rated employers in the state will pay a UI tax of 3.1 percent. The employers with poor experience who previously paid 3.1 percent will bear no increase in taxes. However, those employers with good experience, i.e., with a prior tax of less than 3.1 percent, will be paying increased taxes to bail out the fund. It is unjust that previously low cost employers who already subsidize high cost employers must bear the additional hardship of even higher taxes while the tax of the high cost employers remains the same. Some states solve this by shifting the entire tax schedule upwards evenly. For example, if the low rate were .5 percent and the high 3.1 percent, an equal shift upward of .7 percent would result in a low rate of 1.2 percent and a high rate of 3.8 percent. Thus, all employers end up paying

a proportionately higher tax. States with this type of schedule are indicated with an asterisk in illustration 3.12.

There are a substantial number of states which have maximum tax rates higher than Montana's. By having such rates, these states are better able to distribute the tax burden to those employers who are associated with high unemployment. The maximum tax rates in those other states are as follows:

Illustration 3.12
STATES WITH MAXIMUM UI TAX RATE
IN EXCESS OF MONTANA'S 3.1 PERCENT

	State	Percent Rate		State	Percent Rate
1.	Arkansas	4.2*	18.	Missouri	4.1*
2.	California	4.1	19.	New Hampshire	4.3*
3.	Colorado	3.6	20.	New Jersey	6.2*
4.	Connecticut	5.9*	21.	New Mexico	3.6*
5.	Delaware	4.5*	22.	New York	5.2*
6.	Florida	4.5*	23.	North Carolina	4.7
7.	Georgia	4.5*	24.	North Dakota	4.2
8.	Idaho	5.1*	25.	Ohio	4.3*
9.	Illinois	4.0	26.	Oregon	3.2*
10.	Iowa	4.0	27.	Pennsylvania	4.0
11.	Kansas	3.6	28.	Rhode Island	4.0*
12.	Kentucky	4.2*	29.	South Carolina	4.1
13.	Maine	5.0*	30.	South Dakota	4.1*
14.	Maryland	3.6*	31.	Tennessee	4.0
15.	Massachusetts	5.1	32.	Vermont	5.0*
16.	Michigan	6.6*	33.	West Virginia	3.3
17.	Minnesota	5.0	34.	Wisconsin	4.4*

*States with a maximum rate that shifts up when fund balance is down.

Source: Comparison of State UI Laws, U.S. Department of Labor, January 1, 1975, pp. 2-33.

The Montana tax rate schedule should be revised to expand the tax rate schedule to include higher tax rates until the trust fund reaches the minimum adequate level determined by the division and presented to the Legislature as recommended on page 44. The tax rate schedule should

also be revised to expand the variation between the minimum tax rate and the maximum tax rate. This should be done by raising the upper limit tax rate from 3.1 percent to a percentage which more nearly approximates the experience of those employers who, while currently paying the maximum rate of 3.1 percent, pay taxes less than the benefit costs associated with them.

In an earlier section of this chapter we recommend that the current wage base be changed to an escalating or flexible wage base. Inasmuch as the UI tax revenue is dependent upon both the wage base and the tax rates applied against the wage base, any revision of one factor--tax rates--should be done in concert with an evaluation and possible revision of the other factor, wage base. Nevertheless, the tax rate schedule reflected in Section 87-109, R.C.M. 1947, should be expanded to cover the minimum trust fund balance and a higher upper limit tax rate. The actual tax rates should be determined by the division in conjunction with a proposed change in the wage base. Once this is done, the proposed changes should be presented to the Legislature.

RECOMMENDATION

We recommend that legislation be enacted to expand the current tax rate schedule to raise the upper limit tax rate to more closely approximate the experience of employers whose benefit costs exceed taxes paid.

EXPERIENCE RATING

Inasmuch as unemployment insurance is an insurance program, various features of insurance functions have been incorporated into the program. Among these are the building of reserves, sharing of risk (a certain degree of cross-subsidization) and experience rating. The nature of UI in this regard is adeptly described by Dr. Joseph Becker of Georgetown University:

> "Unemployment insurance has the essential characteristics of group insurance, of which it is a form. The 'insurance company' is the state, and the insured are the employees, who have the right to draw benefits. The employer in effect purchases the insurance by paying his tax to the state. In group insurance it is common practice to require a firm to pay a lower or higher insurance premium (tax) as its employees represent a greater or lesser risk to the insurance fund. The practice of varying the tax rate in some relation to the experience of the individual firm is called 'experience rating.'
>
> "The alternative to experience rating is the uniform tax, under which every firm pays the same tax rate regardless of the degree of risk it represents to the fund. The choice between a uniform tax and an experience-rated tax is a basic decision in constructing a system of unemployment insurance. Of all the countries that have made this decision, only the United States has chosen experience rating. The choice was made only after bitter controversy and it continues to be the object of intense criticism."[23]

According to Dr. Becker, experience rating in UI can be defined as a technique for varying the UI tax on the basis of some aspect of an employer's experience with unemployment. The degree of experience rating in a UI tax system is determined primarily by three factors: (1) the definition of experience; (2) the measurement of experience; and (3) the translation of experience into a tax rate.[24] According to I.C.E.S.A., there are seven possible factors by which employers' experience can be measured:[25]

1. Variation in the number of persons on the payroll

2. Variation in the number of manhours of employment

3. Variation in payroll

4. Total number of separations

5. Compensable separations

6. Benefit wages

7. Benefit payments.

Nearly all of the states now use one or more of the foregoing factors in conjunction with their system of experience rating. All of the states adopted some system of experience rating mainly because of federal incentives to do so. Aside from the federal incentives to adopt experience rating systems, UI experience rating systems also gained acceptance as an incentive for employers to stabilize their unemployment. Since its inception experience rating has gained additional objectives of: (1) securing proper allocation of costs in the UI program; and (2) increasing employers' active interest and participation in the program--especially in "policing" the system so as to prevent unwarranted payment of benefits.

Types of Experience Rating Systems

The federal requirements for experience rating are very general and, as a consequence, the experience rating systems vary widely from state to state. In spite of certain significant differences, all of the systems in use by the states are now categorized into four distinct types: reserve-ratio, benefit-ratio, benefit-wage-ratio, and payroll-decline.

When states first began adopting UI plans and deciding whether to experience rate and which method to use, they often switched from one system to another. When these fluctuations settled down, about 1941,

38 states experience rated, 23 of which used a system called "reserve ratio." In 1947 all states had adopted experience rating systems. Some states picked a system called "payroll decline." Since 1954 the number of states using each of the various systems has remained basically unchanged. The number of states using each of these systems as of January 1, 1976, is shown in the following illustration.

Illustration 3.13
TYPES OF EXPERIENCE RATING SYSTEMS
IN USE BY THE STATES*

	Type	No. of States
1.	Reserve-Ratio	32
2.	Benefit-Ratio	10
3.	Benefit-Wage-Ratio	5
4.	Payroll-Decline	4
	Total	51*

*Including District of Columbia

Source: Comparison of State Unemployment Insurance Laws, U.S. Department of Labor, January 1975.

The significant features and differences of these four types are described by the Comparison of State Unemployment Insurance Laws published by the U.S. Department of Labor.[26]

> Reserve-ratio formula.--The reserve ratio was the earliest of the experience-rating formulas and continues to be the most popular. It is used in 32 States. The system is essentially cost accounting. On each employer's record are entered the amount of his payroll, his contributions, and the benefits paid to his workers. The benefits are subtracted from the contributions, and the resulting balance is divided by the payroll to determine the size of the balance in terms of the potential liability for benefits inherent in wage payments. The balance carried forward each year under the reserve-ratio plan is ordinarily the difference between the employer's total contributions and the total benefits received by his workers since the law became effective.
> The employer must accumulate and maintain a specified reserve before his rate is reduced; then rates are assigned

according to a schedule of rates for specified ranges of reserve ratios; the higher the ratio, the lower the rate. The formula is designed to make sure that no employer will be granted a rate reduction unless over the years he contributes more to the fund than his workers draw in benefits. Also, fluctuations in the State fund balance affect the rate that an employer will pay for a given reserve; an increase in the State fund may signal the application of an alternate tax rate schedule in which a lower rate is assigned for a given reserve and, conversely, a decrease in the fund balance may signal the application of an alternate tax schedule which requires a higher rate.

Benefit-ratio formula.--The benefit-ratio formula (used by ten states) also uses benefits as the measure of experience, but eliminates contributions from the formula and relates benefits directly to payrolls. The ratio of benefits to payrolls is the index for rate variation. The theory is that, if each employer pays a rate which approximates his benefit ratio, the program will be adequately financed. Rates are further varied by the inclusion in the formulas of three or more schedules, effective at specified levels of the State fund in terms of dollar amounts or a proportion of payrolls or fund adequacy percentage. Unlike the reserve ratio, the benefit-ratio system is geared to short-term experience. Only the benefits paid in the most recent three years are used in the determination of the benefit ratios.

Benefit-wage-ratio formula.--The benefit-wage formula (used by five states) is radically different. It makes no attempt to measure all benefits paid to the workers of individual employers. The relative experience of employers is measured by the separations of workers which result in benefit payments, but the duration of their benefits is not a factor. The separations, weighted with the wages earned by the workers with each base-period employer, are recorded on each employer's experience-rating record as benefit wages. Only one separation per beneficiary per benefit year is recorded for any one employer, but the charging of any benefit wages has been postponed until benefits have been paid as specified by the particular state involved. The index which is used to establish the relative experience of employers is the proportion of each employer's payroll which is paid to those of his workers who become unemployed and receive benefits; i.e., the ratio of his benefit wages to his total taxable wages. The formula is designed to assess variable rates which will raise the equivalent of the total amount paid out as benefits. The percentage relationship between total benefit payments and total benefit wages in the State during three years is determined. This ratio, known as the State experience factor, means that, on the average, the workers who drew benefits received a certain amount of benefits for each dollar of benefit wages

paid and the same amount of taxes per dollar of benefit wages is needed to replenish the fund. The total amount to be raised is distributed among employers in accordance with their benefit-wage ratios; the higher the ratio, the higher the rate. Individual employer's rates are determined by multiplying the employer's experience factor by the State experience factor. The multiplication is facilitated by a table which assigns rates which are the same as, or slightly more than, the product of the employer's benefit-wage ratio and the State factor. The range of the rates is, however, limited by a minimum and maximum. The minimum and the rounding upward of some rates tend to increase the amount which would be raised if the plan were affected without the table; the maximum, however, decreases the income from employers who would otherwise have paid higher rates.

Payroll decline/variation plan.--The payroll variation plan (which Montana and three other states use) is independent of benefit payments to individual workers; neither benefits nor any benefit derivatives are used to measure unemployment. Experience with unemployment is measured by the decline in an employer's payroll from quarter to quarter or from year to year. The declines are expressed as a percentage of payrolls in the preceding period, so that experience of employers with large and small payrolls may be compared. If the payroll shows no decrease or only a small percentage decrease over a given period, the employer will be eligible for the largest proportional reductions.

Of the four basic methods of experience rating used by the states our comparison focused primarily on two systems--payroll decline, the present system used in Montana, and reserve-ratio, the system used by most other states. The remaining two types of systems--benefit-ratio and benefit-wage-ratio--are briefly discussed below.

The benefit-ratio system is geared to short-term experience. Thus, it emphasizes quick recovery of lost funds but in the process poses the danger of raising taxes too soon after a recession. This procyclical financing aspect of the benefit-ratio system promotes deeper and longer recessions. It is used by ten states--Connecticut, Florida, Maryland, Minnesota, Mississippi, Oregon, Pennsylvania, Texas, Vermont and Wyoming.

The benefit-wage-ratio system was devised by Frank Cliffe of General Electric in the late 1930's when most states' experience with administration was nil. The system has the advantage of being simple to administer, but only approximates an employer's true experience. Frank Cliffe expressed the view that he would never advise a state to adopt the benefit-wage-ratio system today. Only five states use it now--Alabama, Delaware, Illinois, Oklahoma and Virginia.

Comparison of the two remaining systems--reserve ratio and payroll decline--can be accomplished using the three main objectives of experience rating as criteria. The first factor of comparison is stabilization of employment. Dr. Joseph Becker analyzed this aspect of the reserve-ratio system:

> In the reserve-ratio system there is a fundamental relationship known as the 'natural tax rate.' This is an equilibrium rate toward which the system constantly tends. For all employers whose benefit chargeback rate is less than the maximum tax and more than the minimum tax, the tax rate tends to stabilize at the point where it equals the benefit chargeback rate.
>
> If this equilibrium is disturbed, it tends to reestablish itself. If, for example, the rate of benefit charges grows, the tax rate will increase to match it. Likewise, if taxable payrolls increase--because a higher tax base is legislated or because firms grow in size--or if a higher tax schedule goes into operation, the tax rate of an affected employer will increase, but only temporarily. Eventually the tax rate of such an employer will return to its 'natural' or equilibrium level, where it equals the rate of benefit charges. (When the disturbance in the equilibrium is caused by an increase in taxable payrolls, the firm's reserve will be larger and its tax rate lower at the new equilibrium point.)
>
> A homely example, making use of the 'bathtub theorem,' may help to make this relationship clearer. The tub is like the fund; the water level in the tub is like the reserve ratio; the spigot letting water into the tub is like the inflow of taxes; the drain letting water out of the tub is like the outflow of benefits, of which part is metered, part is not. The metered part consists of benefits that are charged to some employer's account; the nonmetered part consists of noncharged and ineffectively charged benefits. What the principle of the natural tax

> rate says is that the inflow from the tax spigot tends to equal the metered outflow through the benefit drain. Or in other terms, the natural tax rate tends to equal the benefit chargeback rate.[27]

Employers under a reserve-ratio system of experience rating know they will pay for all chargeable benefits against their firm. This knowledge provides these employers with a positive incentive not to create unemployment. In contrast, under the payroll-decline system (used by Montana) employers' UI taxes increase when their payrolls fluctuate or decline. Thus they may be causing unemployment, but they could also be replacing retired personnel with young workers at a lower payrate, thereby decreasing payrolls. The opposite could also occur, general increases in salary for inflation could offset actual layoffs. The reserve-ratio system definitely provides more incentives to employers to decrease unemployment.

Dr. Frank Brechling of Northwestern University studied tax incentives of UI taxes under contract with the Department of Labor.[28] He found that the reserve-ratio system provides employers with an incentive to rely to a larger degree upon voluntary quits rather than laying workers off. This is because an employer is charged for UI benefits if he lays personnel off, whereas if they quit their entitlement is curtailed. The payroll decline system used by Montana does not distinguish between the causes of separations--only that they occur. Again, the advantages of the reserve-ratio system outweigh the payroll-decline method.

Finally, the payroll-decline system of experience rating reacts quickly to changes in business cycles. A turndown in labor demand shows up quickly, first in quarterly, then annual payroll decline. This method accentuates the business cycle, a definitely undesirable and

unhealthy situation in a state like Montana where unemployment rates generally exceed the national rate. In contrast, the reserve-ratio system has a slow reaction to business cycles, thereby resulting in a general counter-cyclical effect which is good.

The goal of stabilization is accomplished by reserve-ratio, in incentives to the firm and overall timing in conjunction with business cycles. Payroll decline offers smaller incentives to the firm to stabilize unemployment and its timing is procyclical. Reserve-ratio definitely is better in reaching this goal.

The second goal of experience rating is cost allocation; the proper charging of taxes to firms from which unemployment originates. The Comparison of State Unemployment Insurance Laws explains the main methods of charging currently used in the U.S.:

> Various methods are used to identify the employer who will be charged with benefits when a worker becomes unemployed and draws benefits. Except in the case of very temporary or partial unemployment, compensated unemployment occurs after a worker-employer relationship has been broken. Therefore, the laws indicate in some detail which one or more of the former employers should be charged with the claimant's benefits. In the reserve-ratio States, the claimant's benefits are charged. There is no charging of benefits to employers in the payroll-decline systems (such as Montana). In some states, the most recent employer gets all the charges on the theory of primary responsibility for the unemployment. All the States that charge benefits to the last employer relieve an employer of these charges if only casual or short-time employment is involved.
>
> Some States limit charges to base-period employers but charge them in inverse order of employment. This method combines the theory that liability for benefits results from wage payments with the theory of employer responsibility for unemployment; responsibility for the unemployment is assumed to lessen with time, and the more remote the employment from the period of compensable unemployment, the less the probability of an employer's being charged. A maximum limit is placed on the amount that may be charged any one employer; when the limit is reached, the next previous employer is charged. The limit is usually fixed as a fraction of the wages paid by the employer or as a specified amount in the base period or in the quarter, or

> as a combination of the two. Usually the limit is the same as the limit on the duration of benefits in terms of quarterly or base-period wages.
>
> If a claimant's unemployment is short, or if the last employer in the base period employed the claimant for a considerable part of the base period, this method of charging employers in inverse chronological order gives the same results as charging the last employer in the base period. If a claimant's unemployment is long, such charging gives much the same results as charging all base-period employers proportionately. All the States that provide for charging in inverse order of employment have determined, by regulation, the order of charging in case of simultaneous employment by two or more employers.
>
> On the theory that unemployment results from general conditions of the labor market more than from a given employer's separations, the largest number of States charge benefits against all base-period employers in proportion to the wages earned by the beneficiary with employer. Their charging methods assume that liability for benefits inheres in wage payments. This also is true in a State that charges all benefits to a principal employer. (Emphasis added)

As stated in the preceding paragraph, most states using the reserve-ratio system also use proportional charging of base period employers. Problems associated with charging come from ineffectively charged or non-charged benefits. As time went by, the UI tax laws were changed in a patchwork fashion gradually exempting more and more employers from charges for employees who quit, were fired for cause, etc. As more and more of these exemptions are granted the objective of the charging system becomes more and more obviated. This can become a problem. It did in Montana. Prior to 1975, Montana had a hybrid system of experience rating which was based on one-third employer years of operation, one-third payroll decline and one-third reserve-ratio. By 1973 almost half of benefits were non-charged or ineffectively charged. By 1975 over 50 percent of the UI benefit paid were non-charged; i.e., not correlated to any employer. This obviated the purpose of the system and resulted in a change to the payroll-decline method in 1975 in an attempt to improve the system. However, the system was not improved.

Theoretically, the payroll decline system (such as that used by Montana) cannot accurately charge benefit costs to those employers from which unemployment emanates. Total costs attributable to employers is the summation of the amount of benefits collected by ex-employees. Payroll-decline only estimates the amount of ex-employees and doesn't even attempt to measure the amount of benefits collected.

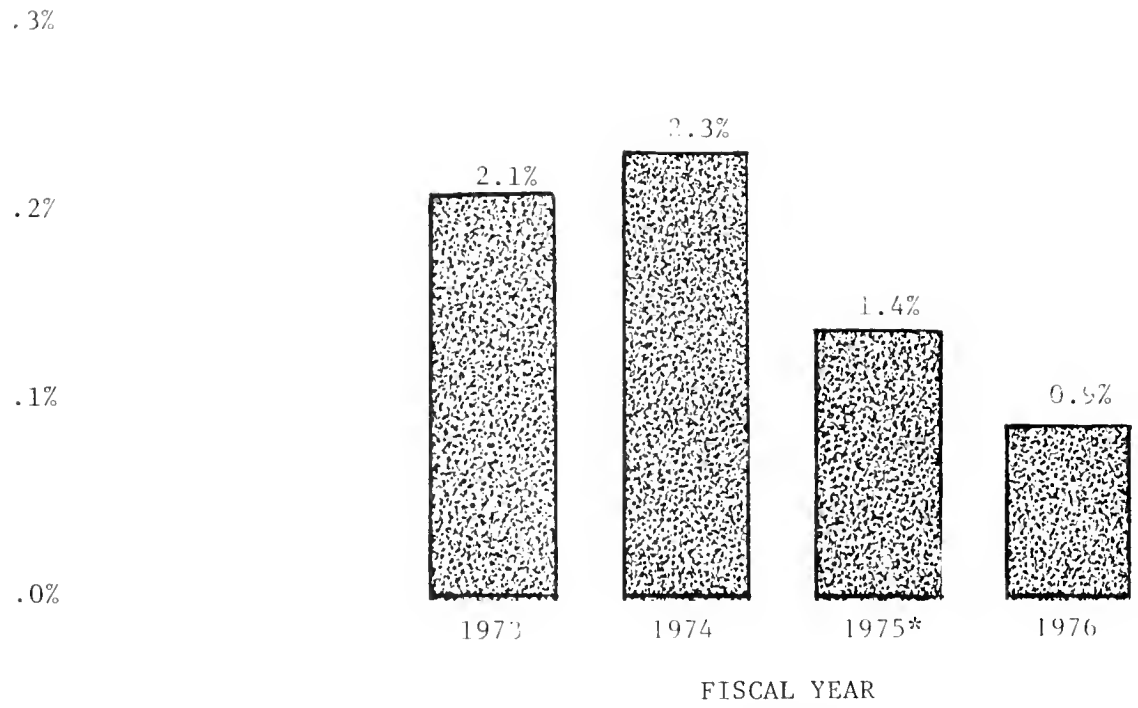
Summarizing, the reserve-ratio system of experience rating is capable of charging the costs of unemployment insurance to the appropriate employers. By design the payroll decline method does not charge back benefits to employers. Consequently, the reserve-ratio system has an advantage with respect to the second goal of experience rating--cost allocation.

Employer interest and participation in the UI program, especially policing the system to insure that excess or illegitimate benefits are not paid, is the last goal of experience rating. Theoretically, the reserve-ratio system again surpasses the payroll decline system in terms of advantages, since benefits are not charged to employers under the payroll-decline system and they are under the reserve-ratio system. Accordingly, under the reserve-ratio system employers have a monetary interest and incentive to police the system.

An official of the division told us that evidence indicates that employers still appeal benefit decisions which they question even since chargebacks were dropped when the payroll decline system was adopted in 1975. This is conceivable since, prior to 1975, only about one-half of benefits were charged back to employers and chargebacks constituted only about one-third of the factors determining the employer's classification. To test the contention that employers police the system to the same

extent now as prior to 1975, we compiled initial appeal decisions on employer appeals as a percent of initial claims for fiscal year 1973 through 1976. Illustration 3.14 shows the trend over this period. This evidence suggests that employer activity in policing the system dropped off in 1975, after the payroll decline system was adopted.

Illustration 3.14
INITIAL APPEAL DECISIONS ON EMPLOYER APPEALS
AS A PERCENTAGE OF INITIAL CLAIMS IN MONTANA

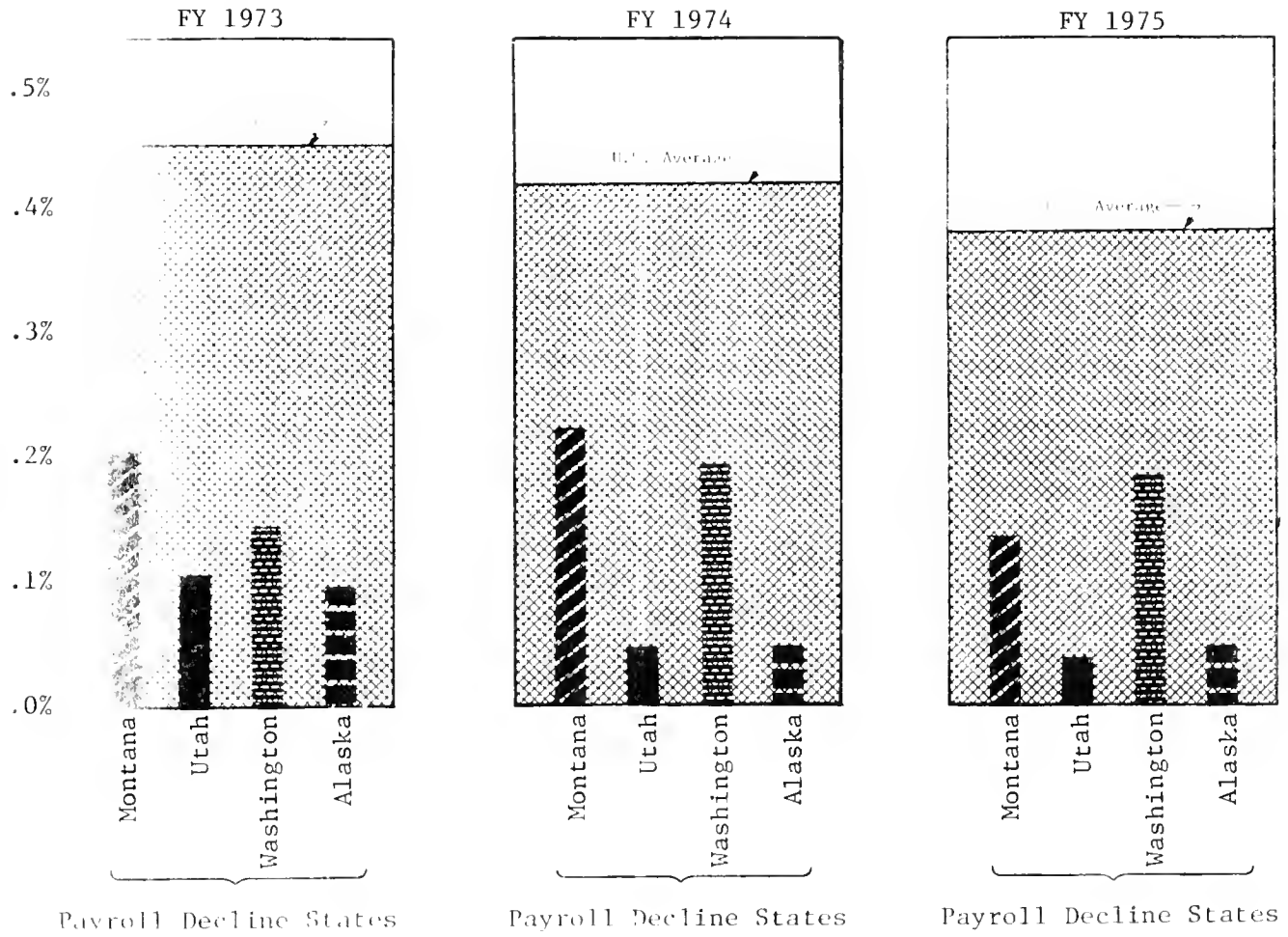


*Montana law changed last quarter of FY 1975

Source: Unemployment Statistics, Montana Employment Security Division

We also evaluated the possibility that employer self-policing activity is less in payroll decline states than states using the other systems of experience rating. We compared the ratio of employer appeals in the four states using payroll decline to the average national appeal rates. The results of our comparison are depicted in illustration 3.15.

Illustration 3.15
COMPARISON OF EMPLOYER APPEAL ACTIVITY
PAYROLL DECLINE STATES VS. U.S. AVERAGE



Source: Office of the Legislative Auditor from Employment Security Division data.

It is obvious from the preceding illustration that employer appeals in the payroll decline states are substantially less than the national average: indicating less self-policing activity by employers. This is particularly evidenced in the preceding illustration by Alaska and Utah which are the only states which use a "pure" payroll decline system of experience rating. The number of employer appeals in these two states is very small.

In summary, the reserve-ratio system functions in a manner which makes employers accountable for their actions, whereas the payroll decline method does not.

Montana Experience Rating System

Montana uses the payroll-decline method of experience rating. The current system, which is prescribed by Section 87-109(c), R.C.M. 1947, was instituted in 1975. Prior to that time the system used was a basically payroll decline system which included provisions for charge-back--i.e., charging employers with benefits drawn by ex-employees. The current experience rating system has no provisions for chargebacks. Rather it operates on the basis of "points" compiled for each employer using the following factors:

1. average annual net percentage in declines in total payrolls for the last three years
2. number of years the employer has paid contributions, and
3. average quarterly percentage declines in total payrolls for the last three years.

Basically under the payroll decline system used in Montana, an employer's tax rate is affected only by his payroll record. There is no direct measurement of the amount paid by the employer versus UI

benefits drawn by his former employees. Furthermore, there is no direct correlation between individual employers and UI benefits drawn by former employees. In other words, the Montana system does not attempt to measure, nor is it even concerned with, the extent to which employer payments exceed former employee UI benefits or vice versa. One of the major problems we had in evaluating the experience rating system used in Montana was our inability to conclusively determine and demonstrate whether it is working properly; i.e., distributing the tax burden equitably on the basis of experience. The data were not collected in such a manner so as to facilitate analysis. However, there is evidence to indicate that a change in experience rating systems may be warranted.

First of all, Montana is only one of four states which use the payroll decline method of experience rating. While this may not seem significant in itself, it warrants consideration. Currently, 47 states (including the District of Columbia) use some other system. See illustration 3.13 on page 64. The system used by Montana is clearly in the minority. It is reasonable to conclude that the other states have not adopted the payroll decline system for valid reasons. On the other hand, there is conjecture as to why Montana adopted it rather than some other method of experience rating. We were advised that there was a general reluctance to accept any form of experience rating in the early years of Montana's UI program. Once it was adopted, the payroll decline method apparently was the least effective experience rating method available. In this regard, our discussions with Dr. Joseph Becker of Georgetown University confirmed this contention. Dr. Becker, an expert on experience rating, told us that:

> "The system of payroll declines is undoubtedly farthest away from genuine experience rating. Invented last, it

was adopted by states that did not really want experience rating but had to adopt some system as a way of diminishing the flow of revenue."

Accordingly, Montana's system of experience rating is the most ineffective and least desirable of the various systems available.

That the experience rating system in Montana is ineffective in equitably distributing the tax burden is illustrated by the following two examples selected for illustrative purposes from the data available at the division.

Example 1. A sugar beet processing plant: Number of employees range from 1500 to 150--fluctuating with the sugar beet season and cyclical sugar demands. During the highest quarter, the employer paid covered wages of $1.1 million while wages in the lowest quarter were $345,000. A sample of 20 people employed by the plant each season for three years disclosed that 13 employees worked all year at the plant--12 full-time and one part-time. The remaining seven employees drew unemployment in the off season of each year tested--1974, 1975, 1976--and most of the seven employees exhausted their UI benefits. Meanwhile the employer paid only a tax rate ranging each year from 2.1 percent to 2.9 percent and never did pay the maximum rate of 3.1 percent.

Example 2. A logging firm: Number of employees ranged each year from eight to eleven. All of the employees were laid off each year during the spring breakup for a period of about two months. The layoff was

predictable each year. The wages fluctuate from a high quarter of $20,463 to a low quarter of $11,126. The total UI taxes paid by the firm over a two-year period were $2,052, yet all of the employees drew UI benefits during the layoff period. However, the tax paid by the firm was never at the maximum rate of 3.1 percent but rather ranged from 1.9 percent to 2.5 percent. Benefits to employees during spring breakup totaled $5,294 for the two-year period; $3,242 more than taxes paid.

It is important to note that neither of the firms in the two preceding examples pay the maximum tax. This is indicative that the present experience rating system does not accurately measure the experience of these two firms with unemployment.

The foregoing examples would be more meaningful if we were able to compare the amount of taxes paid by all covered employers with the benefits drawn by their employees during periods of unemployment. As previously mentioned the division does not compile data to make such a comparison; consequently, we could not do it. This in itself is a criticism of the experience rating system. That is, the division does not know the extent to which the UI taxes paid by an employer correlate to benefits. This information is basic to a determination as to whether the experience rating system is working properly.

Experience rating is supposed to measure an employer's experience with unemployment. That is, measure the cost of unemployment of a firm's ex-employees. We explained on page 67 how the reserve-ratio method does this "naturally." The payroll-decline method merely estimates when

unemployment occurs, it does not actually measure the incidence or duration of unemployment.

Montana should adopt a system of experience rating which equitably distributes the burden of UI taxes and benefits to employers on the basis of their experience. The reserve-ratio method accomplishes this in a much more effective manner than the payroll-decline method now used in Montana. Of the three more effective methods, the reserve-ratio method is more widely accepted and effective in accomplishing the objectives of experience rating.

Inasmuch as the federal requirements underlying the UI program require three years of employer history before an experience-rated tax rate can be applied, any change of experience rating systems in Montana will require the compilation of three years of employment history for employers in Montana. The division MAY BE ABLE TO use previously obtained dat and data processing facilities, to compile the necessary tax and benefit data retroactively. This would enable the UI program to commence a new system of experience rating relatively quickly, possibly by January 1, 1978. On the other hand, if the division is not able to compile the necessary tax and benefit data retroactively, or chooses not to do so due to other constraints, a new experience rating system cannot be commenced until probably 1979.

RECOMMENDATION

We recommend that legislation be enacted authorizing the establishment of a reserve-ratio method of employer experience rating.

ACTUARIAL SERVICES

As is obvious from the information presented in this chapter, the operation of the UI program involves a large number of complex and variable factors such as economic conditions, unemployment characteristics, reserve levels, wage bases, and tax rates. Many of these factors are common to any insurance operation, be it unemployment insurance, disability insurance or whatever. Successful operation of any insurance program, including UI, is dependent upon a scientific understanding and technical management of many factors such as those cited above, most of which are interrelated. In most insurance operations it is generally recognized that actuarial analysis of the factors involved is necessary to successfully operate over the long run.

An actuarial analysis addresses issues which are crucial to the proper operation of an insurance activity such as the establishment of rates and reserves, prediction of factors which might affect rates and reserves, the operation of the insurance activity, and the effect of anticipated and unanticipated trends and events. Virtually all of these factors are also crucial to the proper operation of the UI program. For example, at the outset of this chapter we discussed the current insolvency of the trust fund. We then discussed the minimum trust fund level needed in Montana, the rate at which that minimum should be sought in view of current tax burdens, economic conditions, etc., and what needs to be done with respect to the wage base, tax rates and experience rating. All of these are complex, variable and most importantly of all, interrelated issues. As is obvious from the recommendations we have made with respect to each of the foregoing areas, we have not found simple solutions to these complex issues. We do not know, for example,

just what the trust fund balance should be in Montana and we do not recommend immediate restoration of the trust fund with arbitrarily higher UI taxes. Any restoration should consider the tax burden and economic conditions facing employers in Montana. Accordingly, we have recommended that the division take specific measures to find out what the answers are in each area and formulate specific proposals to the legislature to (1) extricate the state from the current insolvency, and (2) improve the future operations of the UI system. The formulation of these answers and proposals unquestionably involve matters of an actuarial nature--reserves, rates and predictable and unpredictable future conditions and events. Consequently, formal actuarial services should be a fundamental part of the UI operation.

Insofar as we can determine, actuarial services have not been an obvious and fundamental part of the UI operations in Montana. While the U.S. Department of Labor furnishes all of the states with guidance and assistance in many areas, some of which are actuarial in nature, the guidance and assistance is just that--general and uniform in nature. To see that this is true, one only has to peruse the "Taxation" section of the U.S. Department of Labor publication, Comparison of State Unemployment Insurance Laws. Therein it is obvious that there are a multitude of differences among the states in the areas of financing and fiscal operations of state UI programs.

The latitude currently allowed by the federal government is also obvious by virtue of the fact that there have been discussions in recent years about the possible need for federal standards in areas ranging from UI benefits to trust fund solvency. The fact that such measures are being discussed means that there is a wide variance in financing and

benefit practices and problems in these areas among the states. It also means that unless the states independently solve the problems, federal standards may become necessary in which case the federal guidance and assistance will become less and less general in nature.

The states, as a part of their role in the federal-state UI venture, are almost solely responsible for seeing that their UI program is properly financed and operated in a manner which suits each respective state. To meet this responsibility, some states engage actuaries to independently review their UI program and consult with them in the formulation of sound financing decisions. In order to evaluate the need for such actuarial services in Montana, we engaged an actuarial consultant to determine, among other things, (1) what the actuarial requirements of the Montana UI program are, (2) whether the absence of actuarial services has resulted in any obvious or unique problems for the UI program, and (3) whether actuarial services could be of benefit to the UI program in the future. The full text of the actuarial consultant's report is included as Appendix B on page 187.

The actuarial consultant arrived at nine major findings or conclusions:

1. That other states use independent actuaries: six states use them on a regular basis and a number of other states have used them on occasion.
2. Based on a generally accepted measure of fund adequacy (I.C.E.S.A.), the Montana trust fund was inadequate during the period 1962 through 1971 but met the minimum adequacy test in 1972 and 1973.
3. Based on its own measures, the division had determined that the trust fund balance was inadequate every year since 1962.

4. The fluctuations of the trust fund balance should not have been as severe as they were in the last 39 years.
5. The early overfunding of the trust fund may have created a false sense of security with respect to the adequacy of the trust fund.
6. The inadequacy of rates and contributions and the eventual depletion of the trust fund should have been and could have been recognized earlier than it was.
7. Actuarial techniques would have disclosed the precarious financial position of the trust fund leading to measures which would have averted the insolvency of the trust fund.
8. Expected documentation regarding the solvency of the trust fund was absent.
9. The entire rate structure, including the taxable wage base, rate of contribution, experience rating, emergency rates, needs to be reviewed and adjusted.

Based on the preceding, the actuary made four basic recommendations:

1. The total rate structure of the UI program should be reviewed and revisions made in the wage base, the rate schedule, and experience rating.
2. More precise and appropriate measurements of the adequacy of the trust fund should be developed.
3. Consideration be given to acquiring computer software programs for use in conjunction with the financial requirements of the fund.
4. An annual report should be compiled each year which provides information as to the adequacy of the trust fund and, if

appropriate, measures necessary to prevent insolvency or excessive reserves.

The findings, conclusions and recommendations of the actuary generally substantiate the conclusions and recommendations we have made in this chapter. There is little question that actuarial services should play a vital role in the operations of the Montana UI trust fund. In this regard, Section 87-120, R.C.M. 1947, specifically states that the trust fund shall have, if possible, a reserve which shall be set up in accordance with accepted actuarial principles. It is not evident that this has been done. In previous sections of this chapter, we have recommended that the division undertake measures to determine the alternatives available and formulate proposals to the Legislature to solve the problems facing Montana's UI program. Inasmuch as the issues underlying these problems are complex, variable, interrelated, and unquestionably of an actuarial nature, actuarial services should be an integral part of the determination and formulation process, as well as a periodic requirement. Once the current problems are resolved and the UI trust fund is on its way to recovery and restoration, actuarial services should be periodically engaged to evaluate the progress and condition of the UI program.

RECOMMENDATION

We recommend that the division engage an independent actuarial firm specializing in unemployment insurance to:

1. *Assist in the determination of alternatives and the formulation of proposals for the:*
   a. *Establishment of an appropriate trust fund balance;*

b. *Reasonable and gradual restoration of the trust fund;*

c. *Establishment of a variable wage base;*

d. *Revision and expansion of the tax rate schedule; and*

e. *Revision of the experience rating system.*

2. *Conduct periodic independent actuarial reviews of the UI trust fund.*

SUMMARY

Throughout this chapter we discuss various aspects of the taxation system for the UI system in Montana. We recommend setting minimum levels of fund adequacy, developing an action plan to bring the fund balance up to this level, and using independent actuary input in these decisions. We also discuss methods to improve the measurement of employer experience, as well as adjustments in the tax schedules and taxable wage base. As is obvious, the problems and solutions are interdependent. Without a widening of the tax schedule, a more accurate measure of an employer's experience does little to remove the present subsidization of high cost employers. The same applies to the taxable wage base. Following these recommendations will lead to a sound, better managed trust fund. However, there are also a number of other areas where action is warranted to improve the UI program. These areas pertain to the circumstances under which UI benefits are paid. They are discussed in the following chapters.

Chapter IV

PAYMENT OF BENEFITS TO UNEMPLOYED CLAIMANTS

The payment of UI benefits to eligible unemployed workers is the culmination of the UI tax and eligibility determination process. The entire process exists, in essence, to do one primary thing--provide money to eligible unemployed workers until such time that they are reemployed.

Our principal reason for reviewing the UI benefit payment and eligibility process is to determine whether the statutory purpose of the UI program is being carried out--protection of unemployed workers against economic insecurity caused by loss of jobs through no fault of their own. That this is a basic premise underlying the UI program is obvious from the law and a related court case. The policy statement of the Montana unemployment compensation law (Section 87-102, R.C.M. 1947) specifically and explicitly states that the UI program was enacted because the economic insecurity due to involuntary unemployment requires that UI money be used "... for the benefit of persons unemployed through no fault of their own." (See Chapter II, page 9, for the full text of the law.)

This basic premise was enacted as part of the original UI law and has not been modified since enactment in 1937. This purpose is somewhat in conflict with other sections of the law which provide for payment of benefits to persons unemployed through their own actions, such as workers unemployed due to voluntary quits, misconduct discharges, labor disputes and seasonal and unemployed workers whose economic insecurity may be nonexistent because of supplemental income from sources such as retirement income or part-time earnings. The statutory provisions

allowing payment of UI benefits to unemployed workers involved in voluntary quits, misconduct discharges, and labor disputes have been insignificantly modified over the years and remain essentially as enacted in 1937. Seasonal employment is not addressed in the Montana law currently or previously. In regard to the retirement income and part-time earnings, the law permitting UI benefits in conjunction with supplemental income has gradually become more lenient over the years since enactment of the original UI law.

The intent and purpose of the law has been affirmed by the Montana Supreme Court (Scott v. Smith, 376 P.2d 733 (1962)) which considered the purpose of the act and determined that by reason of the explicit policy statement in the law, the law should be liberally construed in favor of the allowance of benefits, keeping in mind, however, that such benefits are to be paid only to "persons unemployed through no fault of their own." (Emphasis supplied) Accordingly, it is evident that in order for the UI program to accomplish its goals of reducing economic insecurity, UI benefits have to be paid, but it is also evident that UI benefits can be paid only to workers who are involuntarily unemployed through no fault of their own.

The UI benefit system is similar in most respects in all states; however, there are some significant differences. One of the controversies today is the disparity of UI benefits among the various states. The federal law and regulations underlying the program do not set minimum standards for UI benefits. Consequently, there is no central pattern of UI benefits and the various states have diverse and complex formulas for determining workers' benefit rights.[29] There are numerous factors which the states variously use to some degree to determine the amount of UI

benefits paid to unemployed workers: these include base period, benefit year, qualifying wages or employment, waiting period, minimum and maximum weekly benefit amounts, recognition of partial employment and partial unemployment, dependants' allowances, and duration of benefits. All of these factors generally have a role in determining who gets UI benefits, how much they get and how long they get them.

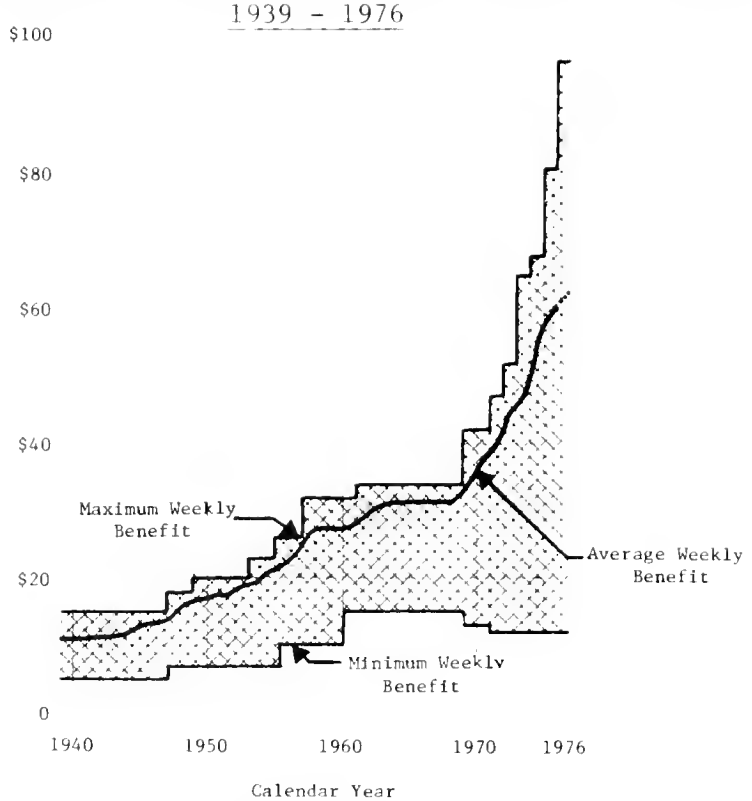
In all states, an unemployed worker's UI benefit rights depend upon his work experience in a past period of time, the base period. To qualify for UI benefits in all of the states a worker must be working for a covered employer and, depending upon the state, must have either earned a specified amount of wages or worked a certain number of weeks or quarters, or have met some combination of wage and time requirements. In Montana, and in all but a few states, unemployed workers are required to wait a period before they can collect unemployment. In Montana, for example, unemployed workers must wait one week--in essence forfeit one week--before they can collect unemployment. This time period acts as a buffer for the UI system by disallowing UI benefits for very short periods of time, i.e., less than one week.

The basic requirements for benefit eligibility are that a totally unemployed worker must register for work at the employment office, continue to report as required by regulation, make claims for benefits, and be able, available, and seeking work. An exception is that an illness or disability occurring after registration for work will not disqualify the claimant. The Montana Supreme Court in Scott v. Smith, supra, declared that the burden of proof of establishment of eligibility for unemployment benefits rests with the claimant.

The UI benefits in Montana currently range from a minimum of $12 per week to an average of $66.05 per week and a maximum of $97 per week. The various programs under which unemployed workers can draw UI benefits ir Montana are described on page 17 in Chapter II.

Section 87-103(b), R.C.M. 1947, provides for a flexible maximum weekly benefit amount for each fiscal year beginning each July 1. Beginning July 1, 1976, the maximum weekly benefit amount is set at 60 percent of the average weekly wages paid in covered employment during the preceding calendar year. Illustration 4.1 shows the maximum weekly UI benefit and average weekly benefit paid by year since the inception of the UI program in Montana.

Illustration 4.1
MAXIMUM, MINIMUM AND AVERAGE WEEKLY UI BENEFITS IN MONTANA
1939 - 1976

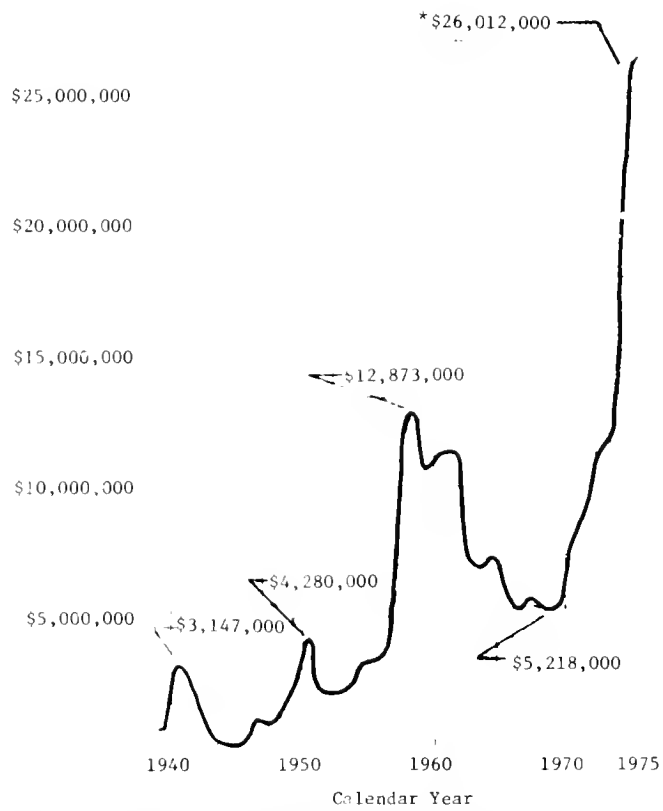


Source: Compiled by the Office of the Legislative Auditor from data in Handbook of Unemployment Insurance Financial Data, Table A-6, and Legislation Affecting Unemployment Compensation, pp. 4-9.

The maximum weekly UI benefit has risen from $15 in 1939 to $97 in 1976. This increase represents both the dramatic increase in wages and the change in the percentage of average weekly wage used to calculate the weekly UI benefit. It is important to note that UI benefits are not subject to income taxes. Consequently, a UI benefit of, say $97 per week, is free and clear in contrast to wages.

Illustration 4.2 depicts the annual UI benefits paid by the state each year since the inception of the program. The illustration depicts only Montana's share.

Illustration 4.2
ANNUAL UI BENEFITS PAID IN MONTANA
UNDER ALL UI PROGRAMS*
1939 - 1975



*Amount paid by the state including state share of federal UI programs. Total state and federal payments in Montana during 1975 were $37.8 million.

Source: Prepared by the Office of the Legislative Auditor from data in Handbook of Unemployment Insurance Financial Data, p. 253.

Section 87-103(b), R.C.M. 1947, provides that the weekly UI benefit is equal to 1/26 of the total wages for insured work paid during the calendar quarter of his base period in which the wages were highest, rounded to the nearest one dollar. Roughly translated, the claimant's weekly UI benefit will be 50 percent of his high quarter earnings. In addition, the claimant must have qualifying wages paid in other than the highest quarter equal to 13 times the computed weekly UI benefit. For example, a claimant who earned $1,300 in the high quarter would have his weekly UI benefit calculated at $50 per week ($1,300 ÷ 26) but must have at least $650 earnings (13 x $50) in other quarters to be eligible. Any amount less than $650 in all the other quarters would result in ineligibility for UI benefits.

The duration of UI benefits is prescribed in Section 87-104, R.C.M. 1947, and generally is dependent on the number of quarters worked during the base period of employment. Illustration 2.3 on page 18 depicts the overall duration of UI benefits under the various UI programs operated by the state. The durations for the basic UI program are determined as follows:

--26 weeks if the claimant had wages earned of $100 or more under insured work in each of three quarters in the base period other than the quarter in which wages were highest.

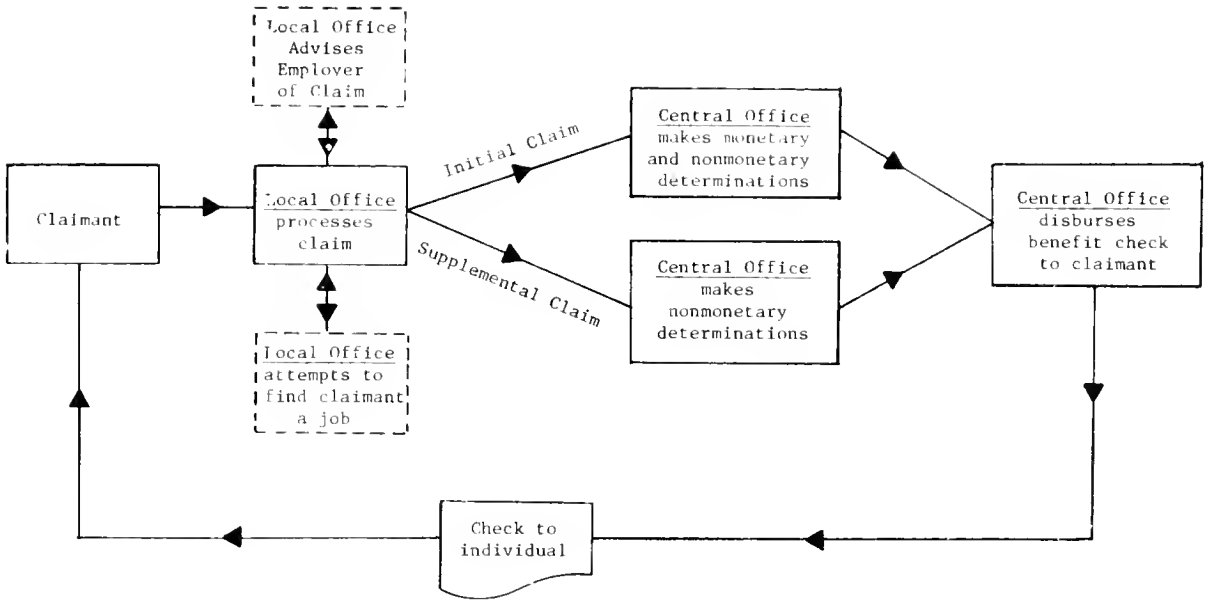
--20 weeks if the claimant had wages earned of $100 or more under insured work in each of two quarters in the base period other than the quarter in which wages were highest.

--13 weeks if the claimant is qualified for UI benefits but is not eligible for 26 or 20 weeks.

As previously mentioned, the basic requirement is that an unemployed worker must register for work at one of the 23 local employment offices around the state. The locations of these offices are shown in illustration 2.1 on page 13. Initially, the unemployed worker must physically appear at the local office to register for work and apply for UI benefits. Once this is accomplished, the unemployed worker is no longer required to come into the local office under the basic UI program unless he wants to or is asked to by the UI personnel. The purpose and extent of these additional visits, called reinterviews, are discussed more fully in Chapter V.

Once an unemployed worker files a claim at a local office the determination of entitlement to UI and the payment process are handled by the central office in Helena. Illustration 4.3 depicts the claim/benefit process in a simplified manner.

Illustration 4.3
PROCESSING OF UNEMPLOYMENT INSURANCE CLAIMS IN MONTANA



Source: Compiled by the Office of the Legislative Auditor from data and observation at the Employment Security Division.

As described at the outset of this chapter, the UI program exists to assist eligible unemployed workers, but at the same time workers must be entitled to such benefits. The administration of the benefit process not only affects those who apply for UI benefits, but also affects the overall success of the UI program in accomplishing the statutory objectives--assisting those who are involuntarily unemployed.

There are indications that lenient or strict administration of the UI program has direct effects upon several aspects of unemployment. While a very stringent program will reduce the dollar outlay for UI benefits, it could prevent some who need and deserve benefits from getting them. Some studies indicate that the lenient granting of UI benefits to workers who voluntarily left their jobs due to choice or avoidable conduct has a definite tendency to extend the duration of unemployment as the amount of UI benefits available increase. In other words, the more an unemployed worker can obtain through UI, the less tendency and motivation there is to find a job. An article published in the Western Economic Journal, March 1971, tested the effect of UI benefits on the demand for leisure time due to the reduction of the price of leisure relative to income, i.e., leisure time is less costly when unemployment benefits are available to ease the burden of unemployment. The study concluded that an increase of one percentage point in the insured unemployment rate was associated with an increase of over 8/10 of a week in the average actual duration of unemployment.[30] This conclusion was supported in another study published by the Public Research Institute which concluded that an increase of $15.00 in benefits leads to an increase in average duration of unemployment of more than one week.[31] Considering that Montana has increased the unemployment benefits

significantly in recent years (see page 88), it is reasonable to conclude, due to the previous cited test results, that unemployment is affected in that greater leisure time will be sought. There is less incentive to work.

Another study published in the Journal of Law and Economics, October 1974, suggests still another important consideration--that the denial of benefits has a substantial impact on the unemployment rate. The study concluded that the doubling of the denial rate would lower the unemployment rate 1.4 percent.[32] The effect of these denials not only has a greater impact on those workers being denied benefits by having to return to work or find other work, but also affects other workers because more rigid screening policies induce people to alter their employment behavior--if voluntary quits cannot draw benefits, fewer individuals will quit or a more diligent job search is applied. As will be observed in the remainder of this chapter, Montana disqualifications for persons leaving their jobs voluntarily or because of avoidable misconduct are among the most lenient of the states. Such leniency in denial of UI benefits undoubtedly contributes to higher unemployment in Montana.

Illustration 4.4 shows the number of claimants and benefit amounts paid to claimants who voluntarily quit their jobs, were discharged for misconduct, were employed in selected seasonal industries, worked part time, or were retired during the period October 1, 1974 to March 31, 1976. A claimant and amount could be double counted on this table because he could fall into more than one group, e.g., a voluntary quit from a seasonal industry who works part time while collecting UI benefits.

Illustration 4.4
NUMBER OF MONTANA CLAIMANTS AND
BENEFIT AMOUNTS IN TESTED CATEGORIES

	18-Month Test Period*			
	Claimants		Benefit Amounts	
	Number*	Percent of Total	Amount*	Percent of Total
Total	55,765*	100.0	$57,092,345*	100.0
Voluntary Quits	9,239	16.6	10,975,543	19.2
Misconduct	1,983	3.6	2,431,014	4.3
Seasonal	13,414	24.0	7,955,550	13.9
Part-time	22,471	40.3	6,794,281	11.9
Retirees	1,989	3.6	1,617,962	2.8

*Number of claimants who received UI benefits during test period October 1, 1974 to March 31, 1976

Note: These numbers and dollar amounts are not cumulative since claimant could fall into more than one group.

Source: Office of the Legislative Auditor from computer analysis of Employment Security Division data.

As shown by the preceding illustration, the amount of benefits paid to individuals in the various claimant groups is substantial. Since the amounts between groups are not cumulative there is no way to project the total effect on the trust fund represented by all the groups taken together. The following sections of the report address these groups individually.

VOLUNTARY QUITS

Montana pays UI benefits to unemployed workers who have voluntarily quit their jobs after a short disqualification and equal postponement

period. Section 87-106, R.C.M. 1947, provides for the payment of UI benefits to voluntary quits as follows:

> "An individual shall be disqualified for benefits--
>
> "(a) If he has left work without good cause attributable to the employment for a period of not less than two (2) nor more than five (5) weeks (in addition to and immediately following the waiting period), as determined by the division according to the circumstances in each case; but, he shall not be disqualified if the division finds that:
> (1) He left his employment because of personal illness or injury not associated with misconduct, or left his employment upon the advice of a licensed and practicing physician, and after recovering from his illness or injury when recovery is certified by a licensed and practicing physician, he returned to his employer and offered his service and his regular or comparable suitable work was not available, if so found by the division, provided he is otherwise eligible."

The original UI act of 1937 provided for a disqualification period of one to five weeks without postponement for workers who quit their jobs without good cause. In 1957 the disqualification was reduced to one to four weeks and returned to one to five weeks in 1961. The current disqualification was enacted in 1963 and has remained in effect since that date. Essentially, the division pays UI benefits to workers who voluntarily left their jobs after making a determination as to whether good cause existed to justify no disqualification.

The stated policy of the UI law, Section 87-102, R.C.M. 1947, clearly stipulates that UI benefits are to be used for persons out of work through no fault of their own. The Montana Supreme Court, in construing Sections 87-102 through 87-106, R.C.M. 1947, expressed the view that application of the law must give effect to the intention of the legislature and ascertained that the purpose of the UI law was not to provide UI benefits to a worker who ceases employment for purely personal reasons but, rather, was intended only for those who are involuntarily

unemployed (McCarthy v. Montana Power Co., 387 P.2d 438, 441). This is the basic premise behind the creation of the UI program and is in consonance with the concept of insurance--an insuree should not be covered for an intentional or willful act which results in loss.

Other State Laws

All states have disqualification provisions for voluntary quits. The U.S. Department of Labor publication Comparison of State Unemployment Insurance Laws states, "In a system of benefits designed to compensate wage loss due to lack of work, voluntarily leaving work without good cause is an obvious reason for disqualification from benefits."[33] There are a number of disqualifications imposed by the states and they consist of varying degrees of severity. The types of disqualifications are:

--Fixed number of weeks

--Variable number of weeks

--Duration of unemployment

In addition, a number of states reduce the claimant's eligibility for UI benefits by a specified number of weeks, usually equal to the disqualification period. Illustration 4.5 shows the number of states using the disqualifications listed above and the trend in laws since 1960.

Illustration 4.5
NUMBER OF STATES USING VARIOUS TYPES
OF DISQUALIFICATION FOR VOLUNTARY QUITS

	Number of States		
Types of Disqualification	1960	1970	1976
Benefits postponed			
Fixed number of weeks	15	13	14
Variable number of weeks	21	17	13
Duration of unemployment	17	28	37
Benefits reduced or cancelled	17	19	17

Note: Columns do not total to 52 for states, Puerto Rico and Washington, D.C. because of double counting on some states. The double counted states have features attributable to more than a single type of disqualification.

Source: Compiled by Office of the Legislative Auditor from the Upjohn Institute and U.S. Department of Labor data.

The preceding illustration shows a trend to more stringent disqualification for workers who voluntarily quit their job. During 1975 and 1976 twelve states have amended their disqualification laws related to voluntary quits--ten of the states' laws became more stringent.

The disqualification of a worker for a fixed number of weeks is specified in law and must be imposed when a worker leaves his job voluntarily without good cause. Illustration 4.6 shows the various fixed-week disqualifications for the states imposing that type of disqualification.

Illustration 4.6
STATES AND DISQUALIFICATION PERIOD WHERE FIXED-WEEK DISQUALIFICATION IS IMPOSED FOR VOLUNTARY QUITS

Name of State	Number of Weeks
Connecticut, Wisconsin	4
Alaska	5
Kansas, Oklahoma, West Virginia	6
Puerto Rico	7
Illinois, Oregon	8
North Dakota, Washington	10
Maine	12
Michigan	13
New Hampshire	26

Source: Compiled by the Office of the Legislative Auditor from the U.S. Department of Labor, Comparison of State Unemployment Insurance Laws (updated).

Seven of the above states, including New Hampshire--with the 26 week disqualification--eliminate the disqualification when earnings from reemployment equal a certain amount specified in the law. In contrast to a fixed disqualification, 13 states, including Montana, impose a variable number of weeks disqualification. This type of disqualification allows the UI agency some latitude in determining the severity of

the penalty for voluntarily leaving a job. In illustration 4.7 we show that there is little uniformity among the states in the number of weeks disqualification where a variable week disqualification is used.

Illustration 4.7
STATES AND DISQUALIFICATION PERIOD WHERE VARIABLE WEEKS OF DISQUALIFICATION IS IMPOSED FOR VOLUNTARY QUITS

State	Number of Variable Weeks
Colorado	6 - 12
District of Columbia, South Dakota	4 - 9
Florida	1 - 12
Maryland	1 - 9
Minnesota	5 - 8
MONTANA	2 - 5
Nebraska	7 - 10
Nevada	1 - 15
North Carolina	4 - 12
Texas	1 - 25
Utah	1 - 5
Wyoming	90%

Source: Compiled by the Office of the Legislative Auditor from U.S. Department of Labor, Comparison of State Unemployment Insurance Laws (updated).

We do not know how the variable disqualification is actually applied in states other than Montana which averaged 3.11 weeks for those who quit without good cause during our 18 month test period.

The justification for only a partial disqualification as experienced in either the fixed week or variable week disqualification is that after a certain period of time, the individual is no longer unemployed by his voluntary action. Rather, he is construed to be unemployed because of economic conditions which prevent finding a job, i.e., unemployment after the average duration, is beyond the control of the worker. However, there has been a continuing trend to impose a more stringent disqualification encompassing the duration of the period related to the voluntary quit.

The U.S. Department of Labor classified 34 states as having a disqualification for the duration of unemployment as of January 1975. This number includes double counting for twelve states using the fixed or variable week disqualification because of features of the state laws which incorporate duration disqualification features to some degree. For example, Colorado and Florida impose both types of disqualifications. In Maryland either disqualification--fixed or variable--may be imposed. In other states of apparent duplicate counting--Connecticut, Georgia, Illinois, Kansas, Maine, New Hampshire, North Dakota, Oregon, South Carolina, Washington and Wisconsin--the disqualification can be terminated by working and earning a specified amount, or retirement features can limit the disqualification. Since January 1975, two states which were double counted--Georgia and South Carolina--and three others--Hawaii, Massachusetts and New Mexico--have amended their laws to eliminate variable week disqualifications in favor of the more stringent duration of unemployment disqualification. Using the U.S. Department of Labor count method, there are now 37 states utilizing the duration of unemployment disqualification. In most instances, these states require the worker to reestablish his right through reemployment for a specified number of weeks and/or earnings equal to a specified amount to terminate the disqualification. The additional work requirements are summarized on the following page in illustration 4.8.

Illustration 4.8

STATE PRACTICES REGARDING ADDITIONAL WORK TO TERMINATE UI BENEFIT DISQUALIFICATION

States	Additional Work or Earnings Requirement
Alabama, Florida, Louisiana, Maryland, Missouri, North Dakota	10 times weekly UI benefit
Arizona, California, New Mexico	5 times weekly UI benefit
Arkansas, Virginia	30 days work
Delaware, Kentucky, Massachusetts	None
Georgia, Idaho, Maine, Mississippi, South Carolina	8 times weekly UI benefit
Hawaii	5 weeks work with 2 days or 4 hours per week
Illinois, Iowa, Pennsylvania	6 times weekly UI benefit
Indiana	Wages equal to weekly UI benefit in each of 10 weeks
New Hampshire	Weekly UI benefit in each of 3 weeks of covered work
New Jersey	4 times weekly UI benefit
New York	3 days work in each of 4 weeks or $200
Ohio	6 weeks in covered work
Oregon	Weekly UI benefit in each of 4 weeks
Rhode Island	4 weeks of work in each of which earnings were at least $20
Vermont	In excess of 6 times weekly UI benefit
Washington	Weekly UI benefit in each of 5 weeks
Wisconsin	4 weeks and $200 earnings

Source: Compiled by the Office of the Legislative Auditor from U.S. Department of Labor, Comparison of State Unemployment Insurance Laws (updated).

The requirement for reemployment serves to establish the worker's earnest attachment to the labor market and, if sufficiently stringent, prevents acceptance of short-term work merely for the purpose of eliminating the disqualification.

Montana Eligibility Determination

To assure that workers who voluntarily quit are fairly treated, the division follows a procedure of evaluating the reason for the voluntary quitting. As with most states, a worker can quit with good cause and not have the disqualification imposed. During the 18-month test period which we considered in our review, the division found that 1,621 of 9,239 claimants who had voluntarily quit were justified (good cause) in voluntarily leaving their jobs and were not penalized. Montana considers only cause related to work and in making this determination the division considers the following factors:

--Effect on the claimant--This includes severity of circumstances causing the quit; adverse effects and the claimant's belief that effect existed; and treatment extended on the job as related to physical, financial, mental or ethical aspects.

--Claimant's attempt to adjust--What did the claimant do to adjust to the job-connected circumstances which led to the quitting; consideration of available alternatives; and reasonableness of action taken in view of the alternatives.

--Customs and conditions of the work--Unacceptable conditions of work which may justify leaving, i.e., violation of employment agreement, legal regulations, equipment necessary to perform work, and attempts to resolve the problem.

--Relationship of leaving to the work--Changing conditions of employment;

health, safety or other conditions related to employment; and

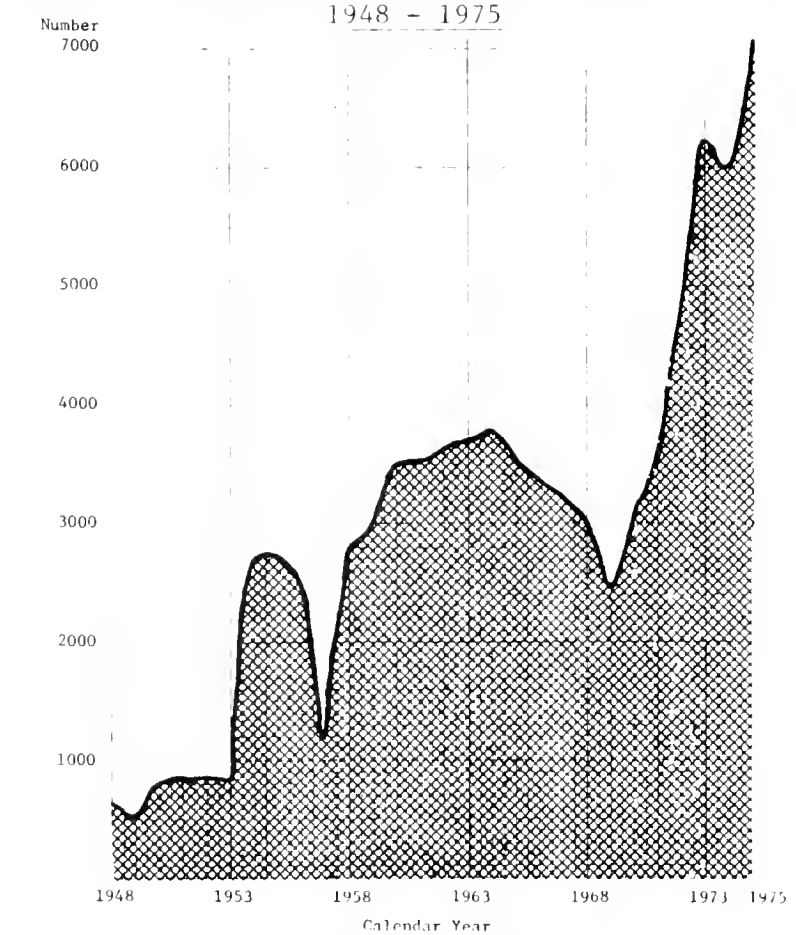
treatment received by claimant in relation to other workers.

Essentially the division follows guidance of the U.S. Department of Labor in resolving separation issues and is interested in determining whether the reason for quitting was "good cause," so as to not penalize the claimant unjustly.

Voluntary Quit Statistics

The division data on voluntary quits is available from 1948 to the present. The number of voluntary quit disqualifications has gradually increased from 688 in 1948 to 7,083 in 1975. Illustration 4.9 shows the number and trend of these disqualifications since 1948.

Illustration 4.9
NUMBER OF MONTANA VOLUNTARY QUIT DISQUALIFICATIONS
1948 - 1975



Source: Office of the Legislative Auditor from Research and Analysis Section, Employment Security Division, data.

We analyzed all payments to voluntary quits for the 18-month period October 1, 1974 through March 31, 1976. During this period, there were 9,239 claimants who voluntarily quit their job. In addition, we compiled a group of "normal" or involuntarily unemployed workers for comparison purposes. There were 32,070 claimants in this group.

Our comparison of these two groups disclosed a number of characteristics. Those workers who voluntarily quit their jobs during the 18-month test period had an average duration of UI benefits of 21.46 weeks for all intervals of unemployment. The comparison group had an average duration for the same period of 14.16 weeks.

Since the disqualification period is applied to about 80 percent of the voluntary quits, a more meaningful comparison involves total duration of benefits plus disqualification period. This figure more closely approximates duration of unemployment. During the 18-month test period, the average duration of unemployment for the voluntary quit group was 24.02 weeks as compared to 14.16 for the comparison group. In other words, those who voluntarily quit their jobs stayed unemployed an average of 9.86 weeks (69.6 percent) longer than the comparison group.

The most logical explanation for this significant difference in duration of unemployment is that, as a group, workers who voluntarily quit their jobs do not seek work as actively as the normal or regular unemployed.

A random sample of 327 drawn from the voluntary quit group for calendar years 1974 through August of 1976 shows that 17.1 percent exhausted the UI benefits for which they were eligible (including Federal Modified Supplemental Benefits--up to 65 weeks total). In contrast, a sample of 293 unemployed workers from the comparison group,

for the same time period, showed that only 7.8 percent of the routinely unemployed workers exhausted their UI benefits. Stated another way, workers in the sample who voluntarily quit their jobs were more than twice as likely to exhaust their UI benefits than the workers who were routinely unemployed.

Again, the most logical explanation for this significant difference is that workers who voluntarily quit are not as active in seeking reemployment as the involuntarily unemployed workers.

Voluntary Quit Claimants

Examples can be used to illustrate the circumstance of claimants receiving UI benefits after voluntarily quitting their jobs. We observed instances where claimants showed a sincere desire to return to work and did return to work shortly after applying for benefits. On the other hand, there were numerous instances where claimants did not aggressively pursue new employment and exhausted UI benefits. Instances of claimants returning to work soon after applying for benefits are as follows:

--Construction laborer--The claimant filed for UI benefits after voluntarily quitting his job three months earlier to attend school. The division determined the claimant eligible for 20 weeks of UI benefits at $68.00 after a two-week disqualification for voluntarily leaving his job. The claimant found a job before receiving any UI benefits.

--Bookkeeper--The claimant filed for UI benefits after voluntarily quitting the job because of working conditions. The claimant was dissatisfied with the wages and hours worked and left without notice. The division determined the claimant eligible for 26 weeks benefits at $49.00 after a four-week disqualification for voluntarily

leaving the job. The claimant received seven weeks of UI benefits for a total of $343.00 before finding a job.

The following are examples where claimants did not return to work soon but rather exhausted available programs:

--Janitor--The claimant filed for UI benefits after voluntarily quitting the job to seek better pay. There were no prospects for another job when the claimant quit. The division determined the claimant eligible for $59.00 per week but disqualified him four weeks. Before drawing UI benefits the claimant found a job as a service station attendant. Six months later the claimant quit the service station and filed for UI benefits. The division disqualified the claimant four more weeks. The claimant received 37 weeks of UI benefits including 23 weeks at $68.00 per week, for a total of $2,390. During this period he was not referred to any job interview. Job search records showed that the claimant contacted one employer three times; he also contacted the union hall, local service stations and a department store. He is now employed in Wyoming.

--Laundry worker--Claimant filed for UI benefits after voluntarily leaving the job. Claimant stated the reason for leaving was arthritis and her doctor advised her to take time off for a rest. Claimant gave no advance notice of quitting and could have obtained almost four months of sick leave had she chosen. The division determined the claimant eligible for UI benefits of $56.00 per week but disqualified her three weeks for voluntarily leaving the job. The claimant drew 62 weeks of UI benefits, collecting $3,472. There were no referrals for job interviews extended to the claimant

by the local office. Even though claimant indicated that the arthritis prohibited much standing and working in damp conditions, she stated that she would not take work other than laundry work. The claimant never found a job and reported that she stopped looking a couple of months after exhausting UI benefits because of her age.

--Installer--Claimant filed for UI benefits after voluntarily leaving his job because of a dispute with his supervisor. The division determined the claimant eligible for $65.00 weekly after a four-week disqualification. The claimant drew UI benefits for 61 weeks for a total of $3,965. Three different weeks the claimant indicated to the job service that he had not contacted any potential employers during the previous weeks. The claimant went to work as a laborer on a highway project about five months after benefits ended.

--Store manager--Claimant filed for UI benefits after voluntarily leaving a job which he had held for 20 years. The claimant advised that he left because of physical and mental strain and daily pressure of the job. The division determined the claimant eligible for UI benefits of $65.00 per week after a two-week disqualification. The claimant received UI benefits for 63 weeks, totaling $4,095. The claimant's job search does not appear aggressive since he contacted only one potential employer in the area for a temporary job for which he had no prior experience, and he sent six job applications to locations outside Montana. The claimant has since found a job as a salesman for a lumber company.

--Nurses aid--The claimant filed for UI benefits after voluntarily leaving the job because of lack of transportation. The claimant

lost a considerable number of shifts because of a dwindling car pool and no bus service. The division determined the claimant eligible for $68.00 per week after a two-week disqualification. The claimant received 31 weeks of UI benefits and then obtained a new job as a nurses aid, working for 2½ months until voluntarily leaving. The reason for leaving was that there was too much work for one person. The claimant waited four months before filing for UI benefits. This time the division disqualified the claimant for five weeks, and the claimant received an additional 26 weeks benefits. In 57 weeks the claimant collected $3,896. The claimant filed nine job search records: four of those indicated the claimant contacted only one potential employer. There were no job referrals by the local office and the claimant is still unemployed.

--News typesetter--Claimant filed for UI benefits after voluntarily leaving the job to follow her husband. The claimant's husband had been transferred to a different city and after four months the claimant quit to move to that location. The division determined the claimant eligible for $68.00 per week after a two-week disqualification. The claimant received 63 weeks of UI benefits totaling $4,284. There were two job search records available in the files: one report showed that there was no contact of potential employers while the other showed two contacts without results. The claimant has not found work and advised that she has quit looking for work because her husband retired.

The granting of UI benefits to workers who voluntarily quit their jobs whether for a short duration or for a lengthy duration is allowed by Montana statute, although such a practice appears to conflict with

the basic policy statement of the UI program: meeting the needs of those workers who are involuntarily unemployed through no fault of their own. While there may be some justification for paying UI benefits to a voluntarily unemployed worker who has been unable to find a job after an extended period of time, the UI benefits paid in Montana substantially exceed that minimum. The average duration of unemployment in fiscal year 1975 was 13.5 weeks, compared to an average disqualification of 3.11 weeks. Our analysis shows that the average disqualification imposed by Montana for voluntarily leaving a job is one of the most lenient penalties possible--only two states have more lenient stringent statutory disqualification criteria.

Most states have adopted laws which contain more stringent disqualification requirements and adhere more closely to the original stated intent of the UI program. These laws retain the insurance concept of the fund because they do not allow payment of benefits to individuals who are responsible for their own economic losses. Legislation should be enacted to amend Section 87-106, R.C.M. 1947, to more closely approximate the intention contained in the policy statement and follow the trend of other states for more stringent disqualification of voluntary quits.

RECOMMENDATION

We recommend that legislation be enacted to amend Section 87-106(a), R.C.M. 1947, to provide for disqualification for the duration of unemployment caused by voluntarily leaving employment without good cause and reemployment requirements to establish attachment to the labor market.

MISCONDUCT DISCHARGES

Background

Montana's UI law provides that claimants who have been fired from their jobs for misconduct can receive unemployment insurance--but only after a disqualifying period. Generally, there are basically two schools of thought on misconduct discharges or voluntary separations. First, individuals who wilfully commit acts which are adverse to their employer's interests become unemployed through their own volition. The worker is presumed to be aware of the prevailing market conditions before he commits an act of misconduct. Therefore, he is entirely responsible for his own unemployment and should be denied benefits. The second philosophy is that after a certain period of time (which varies by state) the unemployed worker who is unable to get a job is no longer personally responsible and should be allowed benefits in spite of the fact that he originally lost his job due to misconduct.

In Gaunce v. Board of Labor Appeals, 524 P.2d 1108, the Montana Supreme Court ruled that an employee's refusal to work overtime and to train a new employee constituted "misconduct" warranting partial disqualification for unemployment compensation upon firing of the employee. Both parties in this case also agreed that the definition of misconduct is:

> "(1) a deliberate, wilful, or wanton disregard of an employer's interests or of the standards of behavior which he has a right to expect of his employee, or (2) carelessness or negligence of such a degree or recurrence as to manifest equal culpability, wrongful intent, or evil design."

The worker who becomes unemployed by an act of misconduct is guilty of wilful neglect of his employer's interests. By his own volition, the claimant is out of work and out of a job. The statement of public policy

underlying the Montana UI laws is expressed in Section 87-102, R.C.M. 1947, which states that the unemployment insurance benefits are intended for persons unemployed "through no fault of their own." Legally, "fault" can be defined two ways (Volume 81, CJS, Social Security and Public Welfare, Section 161):

> "According to some authorities, the word 'fault', as used in such statutes, is not limited to conduct of the employee which is blameworthy, culpable, wrongful, or worthy of censure, but means failure or volition. According to other authorities, however, the word 'fault', as used in the provisions of this nature, connotes more than volition or a voluntary act, and connotes an act to which blame, censure, impropriety, shortcoming, or culpability attaches."

This section, page 41, also states that any inconsistency between the statement of public policy and eligibility provisions of the law is to be resolved by the legislature. Clearly, such a conflict exists in Montana's unemployment compensation law. Persons unemployed through fault of their own and aware of existing labor market conditions are receiving benefits.

The federal unemployment compensation law adopted by the states during 1937-1939, appears to have been based on the philosophy that an unemployed worker is no longer responsible for his unemployment after a certain period of time depending on labor market conditions. However, the trend in the last 20 years has been to tighten eligibility requirements and to make disqualification penalties more severe.

A comparison of the Montana statute prescribing disqualification with the other 50 states shows that as of January 1, 1975, 34 states are more stringent than Montana. The degree of additional stringency varies from several more weeks' disqualification to total disqualification for the duration of the unemployment period. Montana's disqualification is

a variable number of weeks, two to nine, as determined by the division. Sixteen states have fixed weeks of disqualification for misconduct discharges--four have a disqualification period longer than the Montana maximum and only two are less than the Montana actual disqualification--averaging 4.57 weeks. Of the 22 other states which administer a variable number of weeks disqualification (similar to Montana), 14 provide a greater number of disqualification weeks.

Lately the tendency has been to disqualify workers discharged for misconduct for the duration of their unemployment period and to require that the unemployed worker return to work to earn or reestablish qualifying wages, thus showing sincere attachment to the labor market. The number of states with a disqualification for the duration of unemployment plus a reemployment requirement has more than doubled since 1960 and currently stands at 26 states. These states are:

Illustration 4.10
STATES WHICH DISQUALIFY MISCONDUCT DISCHARGES FOR THE DURATION OF UNEMPLOYMENT AND REQUIRE REEMPLOYMENT

1. California
2. Colorado
3. Delaware
4. Florida
5. Hawaii
6. Idaho
7. Illinois
8. Indiana
9. Louisiana
10. Maine
11. Massachusetts
12. Nevada
13. New Hampshire
14. New Mexico
15. New York
16. North Dakota
17. Ohio
18. Oregon
19. Pennsylvania
20. South Carolina
21. South Dakota
22. Tennessee
23. Virginia
24. Washington
25. Wisconsin
26. Wyoming

Source: Comparison of State Unemployment Insurance Laws, January 1975, Department of Labor, table 403.

It is significant to note that the more severe disqualification was legislated in six of these states (Hawaii, Massachusetts, Nevada, New Mexico, South Carolina and South Dakota) during 1975. The reemployment requirements suggest earnings ranging from three to ten times the weekly benefit amount. There are also combinations of these various disqualifications--fixed weeks plus earnings or variable weeks plus earnings.

Misconduct Discharges in Montana

Montana's UI law, Section 87-106, R.C.M. 1947, states in part:

"An individual shall be disqualified for benefits--

* * *

"(b) If he has been discharged:

(1) For misconduct connected with his work, or affecting his employment, for a period of not less than two (2) nor more than nine (9) weeks (in addition to and immediately following the waiting period), as determined by the division in each case according to the seriousness of the misconduct.

(2) For gross misconduct connected with his work or committed on the employer's premises, as determined by the division, for a period of twelve (12) months."

The current provisions of law described above were essentially enacted in 1961 and 1963 and differ slightly from the original version of the law adopted by Montana in 1937. In 1961 the disqualification period for misconduct discharges was changed back to one to nine weeks. Also, in the same year a clause was added to the law that would disqualify gross misconduct discharge cases for a period of twelve months. In 1963 the minimum disqualification period was increased from one to two weeks; the last significant amendment to the law affecting a claimant's eligibility or disqualification period.

The division investigates the circumstances underlying a misconduct discharge to distinguish between a voluntary quit and a misconduct

discharge. In examining the separation, three basic factors are considered: Did the employer or the worker instigate the action to end the work relationship? What was the cause of the separation? And what was the effect on either party? Once the reason for separation is determined to be misconduct, the division determines the claimant's degree of deliberate and wanton disregard of the employer's interests. The division also tries to determine if the act of misconduct was connected with the claimant's work and if the misconduct act was the only reason for discharge. The division's investigative procedures are intended to protect against unjust discharges and unfairly withholding benefits. Such procedures are designed to award benefits to individuals unemployed through no fault of their own--the basic intent of the Montana unemployment compensation law.

The division essentially uses standards developed by the U.S. Department of Labor when making disqualification determinations. Whenever an unemployed worker indicates a misconduct discharge on his initial claim document, the division conducts an investigation principally by contacting the former employer to ascertain whether the reasons warrant a period of disqualification. When the reason for discharge is something other than misconduct, the worker is unemployed without fault and thereby qualifies for benefits without disqualification. Simple negligence with no harmful intent is not misconduct nor is inefficiency, unsatisfactory conduct that is beyond the worker's control, or good faith errors of judgment or discretion. The four basic factors considered are: claimant's control; employment rules, agreements and conditions; effect of the alleged misconduct on the employer; and employer efforts to control or prevent. Selected items which are considered sufficient grounds for misconduct discharges in Montana are as follows:

Not reporting for work	Dishonesty
Absence from work	Intoxication or drugs
Tardiness	Damage to employer property
Violating rules or policy	Union relations
Insubordination	Personal habits or conduct
Choice of resigning or discharge	Carelessness or not performing
Refusal to work	duties

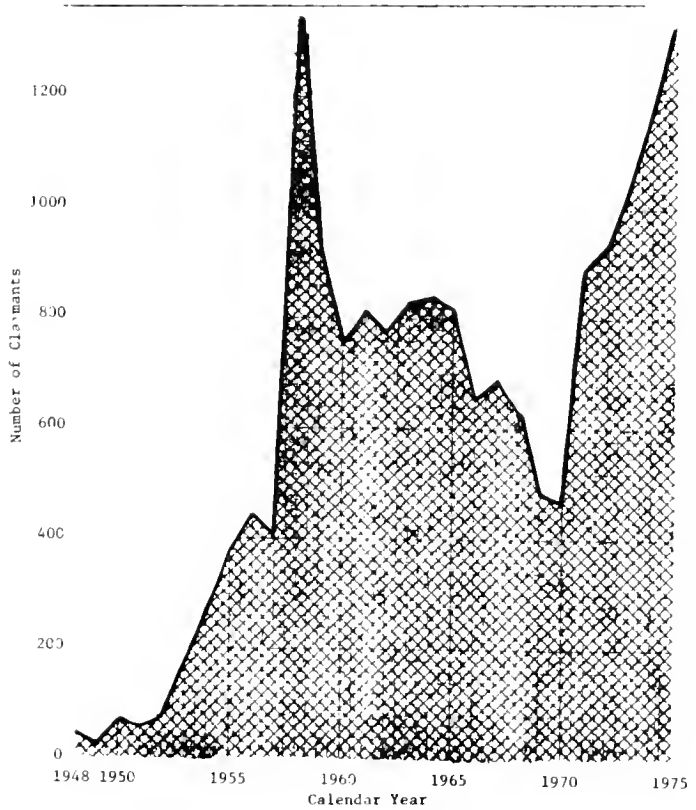
As previously mentioned, Montana law provides that claimants who have been discharged from their jobs for misconduct can receive unemployment insurance benefits after a disqualifying period. During our 18-month test period, October 1, 1974 to March 31, 1976, the division paid $2,431,013 to 1,983 claimants who had been fired by their employers because of misconduct. The average duration of benefit payments for the misconduct discharges was 24.76 weeks including the disqualifying period. In comparison the average duration of the involuntarily unemployed worker, including disqualification period, is only 14.16 weeks. The difference between the two is in excess of ten weeks.

We examined a random sample of claimants who were fired from their jobs to ascertain the employment characteristics of the group. This sample showed that 74 percent of these claimants who began the basic state unemployment insurance program exhausted benefits in that program. In addition, 52 percent of those who began the basic program exhausted the federal-state extended benefits program; about 29 percent exhausted the federal supplement benefits; and 15 percent exhausted the modified federal supplemental benefits. A total of 1,414 of these claimants were disqualified from receiving benefits for an average of 4.57 weeks, which is only one-half of the maximum nine weeks disqualification period allowed by law.

Some of the claimants (569) were not disqualified--the issue was raised but investigation of circumstances by the division showed the claimant was not guilty of misconduct. Our sample of claimants discharged for misconduct showed that "not reporting for work" and "absence from work" were the most common reasons--21 percent and 23 percent respectively. The next highest categories of reasons for discharge were carelessness or not performing duties, 13 percent; personal habits or conduct, 9 percent; and violation of rules or policy, 7 percent. We did not observe any gross misconduct discharges in our sample. However, during 1975 there were only 28 instances where gross misconduct was an issue, of which 24 resulted in disqualifications. We did not examine the propriety of these disqualifications.

The number of misconduct discharges disqualified from one to nine weeks since 1948 is depicted in illustration 4.11.

Illustration 4.11
NUMBER OF UI CLAIMANTS UNEMPLOYED IN MONTANA DUE TO MISCONDUCT DISCHARGES



Source: Compiled by Office of the Legislative Auditor from division data.

The two peak years, 1958 and 1975, coincide with periods of generally high unemployment, not only in Montana but throughout the United States. We did not explore why the number of claimants with misconduct discharges was also high during these years.

Examples of Misconduct Discharges in Montana

We selected the following examples to illustrate instances where workers fired by their employers for misconduct reasons applied for and were allowed UI benefits. The first example is typical of many of the claimants in our sample.

--Miner--This claimant filed for benefits after he failed to report to work when required. The claimant had been reprimanded previously about his loss of work time. The division disqualified the claimant for a three-week period, then allowed him UI benefits of $68 per week. The claimant collected benefits two weeks, totaling $136, then returned to work. The claimant has not applied for benefits since.

Although the preceding example demonstrates the claimant's apparent sincere attachment to the labor market because of his quick return to work, the claimant was allowed to collect two weeks of UI benefits even though he lost his job through his own fault.

In contrast to the preceding example, the following examples demonstrate instances when claimants received UI benefits for unemployment caused by action which was avoidable on their part and an associated lack of sincere attachment to the labor market. Each of the examples represents instances of simple misconduct as opposed to gross misconduct as described on page 112.

--Meat packing plant worker--This claimant filed for benefits after

being fired for chronic tardiness and numerous absences. The claimant had been repeatedly warned orally and in writing and was suspended two weeks for tardiness and absences. The problem continued and the claimant was discharged. The division determined the claimant to be eligible for UI benefits of $47 per week but disqualified the claimant for four weeks due to her misconduct action. The claimant received benefits for 46 weeks, and another claim was filed based on earnings from the firm which had discharged the claimant. This time the claimant was disqualified for five weeks and collected UI benefits of $57 weekly for 35 weeks. Altogether the claimant collected 81 weeks of UI benefits totaling $4,157. When contacted, she advised that she was not currently seeking a job because of pregnancy but would like a job after termination of the pregnancy.

--Bookkeeper--This claimant filed for unemployment insurance benefits after being discharged for absence and misuse of company funds. The claimant had issued an unauthorized payroll check to herself and had cashed several bad checks through the company cash register. The claimant was found by the division to be eligible for $50 per week but disqualified nine weeks for the misconduct discharge. The claimant received benefits for 41 weeks totaling $2,050. The claimant was sent on two job interviews without success. These interviews were for the same job classification--a bookkeeper--however, considering the reason for her discharge it is unlikely that the claimant will ever be reemployed as a bookkeeper. In addition, the claimant filed job search records indicating contact with generally only one potential employer in seeking work. Once the

claimant indicated no contact with potential employers during a two-week period.

--Truck driver--The claimant filed for UI benefits after being fired for failure to abide by safety rules, failure to purchase fuel at designated stop to enable savings to the company, failure to abide by several other company rules, a poor attitude toward company equipment and an unacceptable driving record. The division determined the claimant eligible for UI benefits of $68 per week after a six-week disqualification period. The claimant collected 44 weeks of benefits totaling $2,992. The claimant's job search records show he normally contacted one potential employer each week he was required to report, except on three occasions when there was no job search indicated. He was not referred to any job interviews by the local office and the records show that the claimant is still unemployed.

--Janitor--Claimant filed for UI benefits after being fired for tardiness. He admitted he was late about 30 percent of the time. The division found the claimant to be eligible for $36 weekly after a four-week disqualification period. The claimant received benefits for 61 weeks totaling $2,196. The claimant was required to submit job search records on three occasions which indicated that five potential employers were contacted. The claimant was referred to five job interviews by the local office but was not successful in obtaining a job.

--Truck driver--The claimant filed for UI benefits after being fired for carelessness or not performing duties which cost the employer the loss of 33 customer accounts in a week. The division determined

the claimant to be eligible for $62 per week after a six-week disqualification. The claimant received 33 weeks of UI benefits totaling $2,046. The only required job search record shows that the claimant contacted three potential employers. He received three referrals for job interviews from the local office but was not successful in obtaining the jobs.

--Laborer--The claimant filed for UI benefits after being fired for using a company truck as transportation to a bar at a time when he was supposed to be working. The claimant had previously used the company credit card to make unauthorized personal purchases. The division determined the claimant eligible for $68 per week after a nine-week disqualification. The claimant received UI benefits for 30 weeks totaling $2,040 and exhausting all available programs.

The above examples demonstrate a general lack of desire to satisfactorily work for employers under circumstances which are strictly within the control of the worker. The fact that most discharges occur because of failure to report for work is indicative that being employed is not important to the worker who is undoubtedly conscious of the fact that similar jobs are hard to find. Nevertheless, the worker commits an act which results in the loss of his job.

It does not seem just for a worker to be allowed UI benefits which are financed by his employer when the worker's unemployment is the direct result of his own misconduct. The disqualification of such claimants for the duration of their unemployment plus reemployment for a short time to establish attachment to the labor market would seem to be a reasonable policy for the division to follow, particularly when it is considered that the purpose of unemployment insurance is to provide

benefits to persons unemployed through no fault of their own. It is not consistent with the general purpose of the Montana Unemployment Compensation Act or the concept of insurance that an individual receive benefits (insurance proceeds) for an action which is under his control. As previously mentioned, many other states do not allow this.

RECOMMENDATION

We recommend that legislation be enacted to amend Section 87-106(b), R.C.M. 1947, to provide a disqualification for the duration of unemployment caused by misconduct discharge and reemployment requirements to establish attachment to the labor market.

SEASONAL EMPLOYMENT

Montana's employment opportunities can be generally characterized as seasonal. This is because of the type of industries in Montana, the weather conditions, and because of the granting of benefits to seasonal employees. Montana law does not provide for disqualification of seasonal claimants except for those employed in the educational system. For this reason much of Montana's UI benefit payments are for predictable seasonal layoffs as contrasted to cyclical economic layoffs. Data available at the division shows that 86 percent of the Montana industry has definite predictable seasonality. Because of this predictability, it is known that a large portion of the labor force will be laid off during a particular industry's off season. While 86 percent of the industries do have measurable seasonal fluctuations, the size of these fluctuations varies. Illustration 4.12 shows the relative size of the seasonal fluctuation in the 23 Montana industrial classifications. An index of "0" designates an industry with no seasonal layoffs.

Illustration 4.12

SEASONALITY INDICES OF MONTANA INDUSTRIES

Source: Prepared by the Office of the Legislative Auditor from Department of Community Affairs, Economic Development Division, data.

A comparison of national seasonality indices with Montana seasonality indices by industry shows that Montana is well above the national average.

The only Montana statute that touches on the seasonal employment question is Section 87-105(f), R.C.M. 1947, which excludes payment of UI benefits to employees under contract to a public school or institution of higher education. The disqualification was enacted in 1971 to comply with federal requirements. It precludes payment of UI benefits to teachers and administrators during the seasonal shutdown of schools--the summer vacation. With the passage of H.R. 10210 (the Unemployment Compensation Amendments of 1976) by the federal government, the requirement that there be a contract was deleted and beginning January 1, 1977, states may also deny UI benefits based on services performed for educational institutions for the period between school terms to nonprofessional employees if the employees have reasonable assurance of return to work for the institution. Montana has on occasion disqualified nonprofessionals but the disqualification was based on an established pattern of unemployment between school years, an inadequate job search, or a refusal to accept suitable work.

Reasons Favoring Seasonal Restrictions

The obvious reason for disqualifying claimants in seasonal employment relates to the fact that choice of jobs in an industry where seasonal layoffs are known and predictable is voluntary insofar as the worker is concerned. The worker can seek employment which is not subject to seasonal layoff if he so chooses. Another reason is that with such definite predictability it is doubtful that insurance concepts apply to these industries. As mentioned in Chapter II, page 4, six

tests must be met to establish an insurable risk. Involuntary risk constitutes the first test--the unemployment must be a pure risk and not a risk created by the insured or one which he has control over. Seasonal employment does not pass this test since the worker has employment which will have predictable seasonal layoffs. Seasonal employment fails to pass the fifth test which is that only part shall be unemployed at one time. This test anticipates that a large portion of the labor force will never be unemployed. In highly seasonal industries, this situation is actually reversed--the largest portion are unemployed during the seasonal layoff. Hence, technically seasonal industries are not an insurable risk.

An article published in the Fall 1973 edition of The Public Interest summarized opposition to paying UI benefits for seasonal unemployment as follows:

> "The general effect of unemployment compensation is to increase the seasonal fluctuations in the demand for labor and the relative number of short-lived, casual jobs. It does this by raising the employee's net wage for such unstable jobs relative to the cost of employers. This distortion in the cost of unstable employment influences the patterns of production and consumption in the economy. Because the price of unstable labor has been artificially subsidized, employers organize production in a way that makes too much use of unstable employment.
>
> * * *
>
> "A worker who accepts a seasonal job knows that he will be laid off (or will have a much greater risk of being laid off) when the season ends. Similarly, a worker in a casual or temporary job or in a highly cyclical industry knows that he is much more likely to be laid off than a worker with a regular job in an industry that is not cyclically sensitive. If there were no unemployment compensation, workers could be induced to accept such unstable jobs only if the wage rate were sufficiently higher in those jobs than in the more stable positions in which they could find alternative work. The pay differentials among

> jobs would reflect the chances of being laid off and the expected duration of unemployment after being laid off. The higher cost of labor in unstable jobs would induce employers to reduce the instability of employment by greater smoothing of production through increased variation in inventories and delivery lags, by additional development of off-season work, by incurring costs to improve scheduling, by less cyclical sensitivity of unemployment to changes in production, by the introduction of new techniques of production (e.g., new methods of outdoor work in bad weather to reduce seasonal layoffs), and so on. ... The effect of unemployment compensation is to offset the market forces that would otherwise prevent an excessive amount of unstable employment. Because unemployment compensation provides a subsidy to workers in unstable employment, it reduces the wage differential required to attract workers to seasonal, cyclical, and temporary jobs. Because employers pay a relatively small premium for their unstable employment, there is little incentive to reduce this instability." (Emphasis theirs)[34]

Reasons Against Seasonal Restrictions

Wyoming repealed its provisions providing seasonal restrictions for the following reasons:

--The provision has worked to the disadvantage of some claimants who have demonstrated their firm attachment to the labor force.

--The small number of firms that applied for and received a seasonality designation tended to indicate a general lack of interest by seasonal employers.

--The provision was difficult and excessively expensive to administer.

Other states also repealed the seasonal provisions because of administrative difficulties.

The Upjohn Institute has studied the question of providing UI benefits for seasonal employment and has summarized its conclusions in a publication The Treatment of Seasonal Unemployment Under Unemployment Insurance. Essentially the publication opposes seasonal restriction as follows:

"The real test as to whether unemployment should be compensated is not whether the unemployment is unpredictable, but whether it is involuntary. Since the purpose of unemployment insurance is to compensate involuntary unemployment, if the worker (1) has been laid off for lack of work, (2) has had enough employment to indicate attachment to the labor force by meeting the qualifying requirements for benefits, (3) wants to work outside the season, and (4) is genuinely looking for work, any unemployment experience should be compensated. This is the position of those states that do not have seasonal provisions.[35]

* * *

"Most seasonal unemployment is experienced by workers who are in the labor force year round and who are working in industries that operate, although with seasonal fluctuations, on a year-round basis. It is therefore important to look at the total financial burden of seasonal unemployment; how it is distributed among employers and whether any financial changes should be made.

* * *

"Financial considerations were probably the principal determining factor in the enactment of seasonal provisions. However, since employers who have been ruled as seasonal under the special seasonal provisions employ only a very small fraction of the workers covered by such state laws, the savings have been small.

"It is the conclusion of the author that special restrictions on the benefit rights of seasonal workers are unjustified. Most seasonal unemployment is a risk that should be protected by unemployment insurance. It is inequitable to discriminate among workers employed in industries that have seasonal fluctuations and single out those who work for firms that operate only during part of the year. Abuse of the system either by seasonal workers or seasonal employers has probably been exaggerated. The administrative problem of identifying seasonal employers and seasonal workers for special treatment is expensive and complicated. And the savings to the state unemployment insurance funds in benefits by special seasonal provisions have been relatively minor. The provisions still existing in the 13 state laws should therefore be repealed.

* * *

"A more effective method of screening out workers who by choice work only during a short seasonal period is to stipulate, as a qualifying requirement for benefits, that the worker must have been employed for a substantial number of weeks in the base period preceding his unemployment. Many of the states have qualifying requirements in terms of earnings that only roughly measure the length of attachment of

> the worker to the labor market. There has been a slow trend among the states to require a minimum number of weeks employment such as 20 in the base period with minimum earnings in such weeks. This can be an effective method of screening out many workers who work for only a short period each year in seasonal work. It will not, however, screen out all such workers, since some part-year workers may still work for the minimum number of weeks required or even longer."[36]

The study recommended repealing seasonal restrictions, requiring eligibility qualification of at least 20 weeks of employment with substantial earnings, a more stringent work test to assure genuine availability for work and increased maximum taxes so that highly seasonal employers could pay more of the benefit burden.

Seasonal Provisions of State Laws

In most states no distinction is made between seasonal employment and nonseasonal employment. When the UI program began many states were concerned that seasonal industries would draw heavily on the funds and cause possible insolvency of the system. Therefore, when the states adopted UI laws, 20 states included provisions in the original law restricting UI benefits for workers in seasonal industries. Soon after 13 more states adopted such provisions. However, since early in the program the states have gradually repealed these restrictions and today only 13 states have special provisions of this type in effect. In most of these 13 states, the designation of seasonal industries is the first step toward disqualification of earnings. The most frequent restriction used provides that wage credits earned in seasonal employment are available for payment of benefits only for weeks of unemployment that fall within the operating season of the employer where they were earned. Another restriction is one where claimants are allowed no benefits where a large portion of the wage credits were for seasonal work performed. The general intent of all of these provisions is to restrict the payment

of UI benefits to workers who look only to seasonal industry for their livelihood.

Illustration 4.13 shows the effect of seasonal designations of 14 states in 1969 (Wyoming has since repealed the seasonality law) and the number of employees affected by the designations.

Illustration 4.13
NUMBER OF EMPLOYERS CLASSIFIED AS SEASONAL, THEIR LEVELS OF EMPLOYMENT, AND THEIR HIGH MONTH COMPARED WITH AVERAGE MONTHLY COVERED EMPLOYMENT IN 14 STATES WITH SEASONAL PROVISIONS, 1969

State	Number of seasonal employers	Level of employment by seasonal employers		High-month employment as percent of state average monthly covered employment
		High month	Low month	
Arizona	36	2,288	648	0.6
Arkansas	80	4,161	1,445	1.0
Colorado	36	10,959	2,581	2.2
Delaware	26	3,913	1,639	2.0
Maine	167	5,154	498	2.3
Minnesota	18	NA	NA	--
North Carolina	64	NA	NA	--
Ohio	43	31,366	19,517	1.1
South Carolina	7	1,860	101	.3
South Dakota	33	1,017	14	1.1
Virginia	14	1,533	326	.2
West Virginia	4	1,739	175	.5
Wisconsin	NA	NA	NA	--
Wyoming*	7	1,480	486	2.0

Note: NA--not available.
*Seasonal provision amended in 1971 making it inoperative.

Source: The Upjohn Institute, The Treatment of Seasonal Unemployment Under Unemployment Insurance, April 1972, p. 31

Other states which do not specifically address seasonal employment provide incidental exclusions through eligibility determinations of qualifying wage levels and workweek requirements. There has been a slow trend toward adoption of minimum work week requirements in preference

to seasonal restrictions. Illustration 4.14 shows those states which use a minimum week requirement to qualify workers for UI benefits.

Illustration 4.14
STATES USING WEEKS OF WORK QUALIFICATION,
NUMBER OF WEEKS AND MINIMUM WAGES REQUIRED

State	Weeks of work	Minimum base-period wages required
Florida	20 weeks, average $20 or more per week	$ 400.00
Hawaii	14 weeks and 30 times weekly benefit amount	150.00
Michigan	14 weeks at $25.01 or more per week	350.14
Minnesota	18 weeks at $30 or more per week	540.00
New Jersey	20 weeks at $10 per week; or $2,200	400.00
New York	20 weeks at weekly average of $30 or more per week	600.00
Ohio	20 weeks at $20 or more per week	400.00
Oregon	18 weeks at $20 or more per week	700.00
Rhode Island	20 weeks at $20 or more per week; or $1,200	400.00
Utah	19 weeks at $20 or more per week	700.00
Vermont	20 weeks at $30 or more per week	600.00
Washington	16 weeks at 15 percent of state average wage; or 600 hours of employment	1,150.00
Wisconsin	17 weeks at $38.01 or more per week	720.18
Wyoming	20 weeks with 20 hours of work per week	800.00

Source: Compiled by Office of Legislative Auditor from Comparison of State Unemployment Insurance Laws, pp. 3-28.

Some states give special attention to the work test for claimants who earned all or a large part of base-period earnings in seasonal employment through more intensive interviewing and offering of suitable jobs.

Examples of Montana Seasonal Employment

As stated previously, Montana industry generally has a higher seasonality than the same industries nationwide. Because the law does not address seasonality, the division does not identify seasonal versus unseasonal industries. However, they do measure seasonal trends in all

industries. Through the process of identifying eight seasonal industries which have the greatest seasonality, we were able to determine unemployment experience for those industries. Generally the results show that the duration of unemployment in the more seasonal industries is shorter than that of the normal unemployed test group referred to earlier in the voluntary quit and misconduct discharge discussion. The duration of UI benefits for seasonal claimants was 9.9 weeks as contrasted to 14.2 weeks for the normal test group. We also found that taken as a group, the selected eight seasonal industries experienced a lower chance of becoming unemployed than all Montana industries taken as a whole--22 percent of the seasonal workers receiving UI benefits as contrasted to 25 percent of the total of all covered workers. However, examination of specific seasonal employers shows that some industries do pay UI taxes which are substantially less than the cost of UI benefits paid to their employees. This is demonstrated by the following examples:

--Sugar beet processing plant--The plant is highly seasonal in that operations peak each year for processing the annual sugar beet harvest in the last quarter. A random selection of 20 employees who returned to work at the processing plant three years running was made to compare taxes and benefits. The test showed that seven employees received unemployment insurance benefits and that the benefits paid exceed the employer contributions by 150 percent. The taxes and benefits paid for these 20 employees during the three years are as follows:

Year	Taxes	Benefits
1974	$2,436	$ 4,314
1975	2,139	8,450
1976	2,784*	5,615
Total	$7,359	$18,379

*Calculated on the basis that maximum earnings of $4,800 would be taxed at the company tax rate of 2.1 percent.

The employment during those years fluctuated from a low of 136 employees to a high of 1,553 employees.

--Logging company--The total number of employees were considered in this example. The company functions as most Montana logging firms do--a seasonal shutdown occurs every year for the spring thaw. The total benefits received by the company employees during the spring thaw only for those years tested exceeded tax contributions by 209 percent. The taxes and benefits paid by the company for the three years are as follows:

Year	Taxes	Benefits
1974	$1,189	$2,370
1975	863	2,924
1976	994*	4,113
Total	$3,046	$9,407

*Calculated on the basis that maximum earnings of $4,800 would be taxed at the company tax rate of 2.3 percent.

This firm did not have a large fluctuation of employment--it simply laid off the crew each spring when logging could not be accomplished.

The circumstances described in the above examples are characteristic of many firms and industries within Montana. However, the absence of

mechanized records precluded extensive examination of indivudal firms. We believe that highway construction, which curtails during the winter months, would present the same type of examples. Interestingly, an example in the hotel-motel industry, which is affected by tourism, showed a relatively low experience of claimants who received UI benefits. The company operates a tourist hotel which totally closes during winter months. Peak employment occurs during June through August. College students were the majority of the work force hired during this time. We selected 27 employees who had been employed in the 1974 and 1975 seasons to determine UI benefit experience. We found only two who received benefits in 1974 and none in 1975.

The UI benefit payments for the industries with the highest seasonality indexes totaled $7,955,500 for the 18 months, October 1, 1974 to March 31, 1976. Rather than being insignificant as previously suggested by the Upjohn Institute, the seasonal unemployment is considerable. The application of more stringent work tests would be useful in reducing UI payments to seasonally unemployed. As mentioned on page 173 in Chapter V, the Billings local office used this technique to good advantage for first time claimants, many of whom were school employees. This was successful in part because there were similar jobs available which could be offered to the claimant. Currently in Montana, a worker can work only a few weeks in two calendar quarters with sufficient wages, and be eligible for 13 weeks of UI benefits. Because of this, some seasonal workers who are not otherwise eligible qualify for UI benefits.

The Upjohn Institute recommendation for a revision of the minimum qualifying employment to at least 20 weeks of work would assist in deleting some seasonal claimants. As stated on page 122 of this chapter

the current Montana law does not recognize seasonal employment and does not specify a work period but rather requires minimum earnings in more than one quarter for all workers.

A 20 week work requirement in Montana would eliminate some of the seasonal employees from the UI program--especially those employed in the tourist industry. But it would not affect those in the most significant seasonal industries in the state--logging, construction, food and kindred products, etcetera. The employees in these industries would still be able to qualify for UI benefits even though a large part of their unemployment is certain and predictable.

The teaching industry is seasonal and the disqualification required by statute is no less applicable in principle to workers in other highly predictable seasonal industries. In other industries, the layoff is often merely temporary until weather conditions permit a resumption of activities. The claimants often return to the same employer. In the instance of the sugar beet processing plant, we noted a high number of employees who return year after year following a six-month layoff. Similarly the logging firm example demonstrates an "assured" return following the thaw. Thus it is evident that the characteristics of predictable seasonal layoffs are similar to the one industry which cannot be paid benefits during the off season.

Montana is a highly seasonal state and this leads to special problems in the area of unemployment insurance. To solve these, Montana could designate seasonal industries and not allow benefits to their employees during their off season. Unfortunately, this has two problems: (1) it's difficult and expensive to administer, and (2) large decreases in income in small towns during an "off season" could drastically affect

their economies. On the other hand, evidence in this section points to three steps which tie in with other recommendations in this report and serve to alleviate a major portion of the special seasonal problems. First a special work test (see Chapter V) should be applied to workers in the seasonal industries during their off season to assure they are still available for and actively seeking work. More stringent work tests are recommended on page 175. Second, the experience rating should be expanded (see Chapter III) to prevent subsidies of high cost firms and the resultant incentives to become more seasonal. The recommendations shown on page 78 would partially reduce the seasonal impact of these industries. Finally, the qualifying period could be stated in terms of weeks--the Upjohn Institute recommends at least 20. This will prevent high wage employees from qualifying for benefits with just a few weeks' work.

RECOMMENDATION

We recommend that legislation be enacted to amend Section 87-103(c), R.C.M. 1947, to incorporate a requirement for a qualifying period of a minimum number of weeks of work.

PART-TIME EMPLOYMENT

The UI laws in Montana allow an unemployed worker to work a certain amount of part-time work and still draw UI benefits. Although virtually all the states allow claimants to work part-time to some degree, Montana is unique in that certain features of the Montana UI law allow certain claimants working part-time to be considered "totally unemployed" while in all other states they would be considered partially employed.

When first enacted in 1937, the Montana law did not recognize part-time employment in defining total unemployment. This changed with the next legislative session so that the first $5 of part-time earnings earned by a claimant were not considered wages in determining eligibility for UI benefits. Subsequent revisions occurred in 1945, 1955, and 1969. The most recent change, in 1969, is still in effect and "total unemployment" is prescribed by Section 87-149(a)(3), R.C.M. 1947, which provides:

> "(3) As used in this subsection the term 'wages' shall include only that part of remuneration for work which is in excess of twice the weekly benefit amount, and the term 'service' shall include only that work in excess of twelve (12) hours in any one week." (Emphasis supplied)

Generally, the controlling factor in the above is the hours of work--most of those drawing UI benefits work twelve hours but seldom exceed the monetary earnings limitation within the hourly limitation.

Other states allow for partial employment by disregarding a portion of part-time earnings. They disregard from earnings either a fixed dollar amount, a portion of the weekly UI benefit, or some combination of the two as can be seen from illustration 4.15.

In the majority of states, a worker is considered partially unemployed in a week of less than full-time work if less than the weekly UI benefit or the weekly benefit plus earnings disregarded, is earned from the regular employer or odd jobs. In contrast, claimants in Montana are considered totally unemployed with no more than twelve hours of work and earning less than twice the weekly UI benefit. The Montana statute is an either/or situation--the claimant either stays under the prescribed hours and earnings or he does not receive benefits. The other states prescribe a proportional deduction of earnings in computing the weekly UI benefit when partial unemployment occurs.

Illustration 4.15

STATE PRACTICES IN DISREGARDED EARNINGS FOR COMPUTING UI BENEFITS FOR PART-TIME EMPLOYMENT

State Practice	Number of States*	Amount Disregarded
Disregard a fixed dollar amount	21	$2 to $30
Disregard a portion of weekly UI benefit	16	1/5 to 1/2 of weekly UI benefit
Disregard a portion of wages	4	1/5 to 2/5 of wages
Disregard greater of fixed amount or portion of weekly UI benefit	7	$3 to $10 or 1/5 to 1/2 of weekly UI benefit
Disregard lesser of fixed amount or portion of weekly UI benefit	1	$10 or 1/2 of weekly UI benefit
Disregard a portion of wage up to a portion of weekly UI benefit	1	1/2 of wages up to 1/2 of weekly UI benefit
States with unique reduction features	2**	**
Total	52	

* Includes District of Columbia and Puerto Rico
**Includes Montana and New York

Source: Compiled by the Office of the Legislative Auditor from data in Comparison of State Unemployment Insurance Laws, U.S. Department of Labor, Table 306.

Generally the laws in the other states which recognize partial unemployment based on the claimant's weekly UI benefit serve the basic purpose of UI in meeting needs of insecurity due to unemployment. These laws allow a fraction of earnings to encourage acceptance of part-time work but provide for a reduction of benefits to avoid payments when claimant's earnings are substantially above the basic benefits. The Montana law relative to part-time employment does not effectively consider earnings. Consequently, a number of claimants supplement the basic benefit very sufficiently through the part-time earnings on a routine

basis. Further, the Montana statute has created an apparent work disincentive because claimants will not normally work more than the maximum hours. The benefit reduction provisions of other states do not limit the hours but more importantly focus on earnings in relation to the weekly UI benefits. These laws provide a sliding scale that does not inhibit earnings once a part-time job is taken. The Upjohn Institute, in its publication Strengthening Unemployment Insurance, suggests that "to minimize work disincentive effects, the full weekly UI benefit payable to a claimant for total unemployment should be reduced by no more than two-thirds of any amount he earns in minor or part-time employment." The publication further suggests that "the weekly benefit amount for total unemployment should be reduced for current earnings gradually so that each dollar earned will reduce the benefit by 67 cents and no earnings should be disregarded. This approach will assure a complete phase-out of the claimant's benefits at the point where his earnings equal 1½ times his weekly benefit amount. As long as his earnings are below this level, he is entitled to some benefit but always has some incentive to earn more."[37]

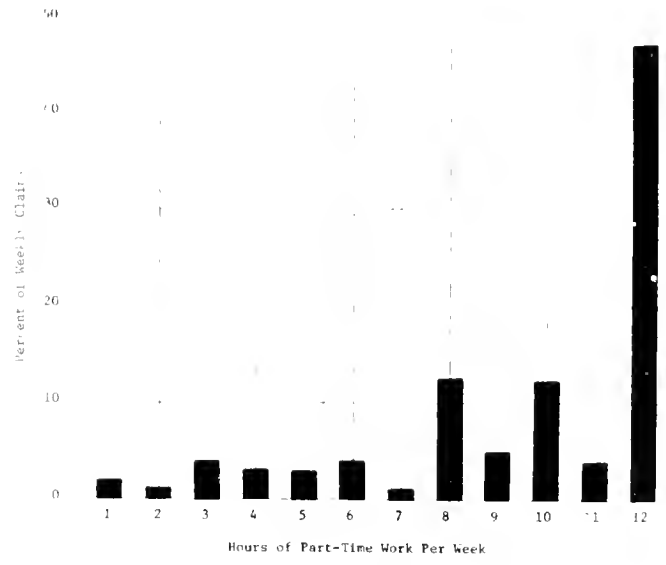
During the period October 1, 1974, to March 31, 1976, there were 22,471 claimants in Montana who had performed part-time work at some time during their unemployment--most of these claimants had only sporadic instances of part-time work during their spell of unemployment. In 1975 approximately $4.4 million in UI benefits were paid to individuals that worked part-time, or 11.7 percent of all UI benefits paid that year.

In reviewing the circumstances in which claimants are receiving benefits and working part-time we observed several situations which appear contrary to the principles of providing unemployment insurance. Briefly, these areas are:

1. The hourly limitation creates a work disincentive.
2. The earnings are used to supplement unemployment insurance benefits sometimes in excess of the weekly benefit amount.
3. Certain seasonal employers use the twelve-hour limitation extensively for numerous employees in the off-season.
4. Occasionally claimants are requalified for a new claim year based on part-time earnings.

A random test of 96 benefit payments where claimants worked part-time and received benefits showed that almost one-half of the claimants worked the maximum allowable time and still retained eligibility--twelve hours. The law as written precludes payment of benefits if the number of hours worked exceeds twelve hours, i.e., he cannot work more than twelve hours and be eligible for UI benefits. Illustration 4.16 depicts a graph which shows the tendency of the claimants tested to work twelve hours. As can be seen, 47 percent of the payments are to claimants working part-time the maximum allowable hours--suggesting that more work was available but was not considered because of disqualification.

Illustration 4.16
MONTANA PART-TIME HOURS WORKED AS
PERCENT OF WEEKLY CLAIMS



Source: Compiled by Office of the Legislative Auditor from division data

In addition to the above, certain seasonal employers use the twelve-hour limitation repeatedly to allow their employees to receive benefits. For example, one employer (a concrete company) laid off 20 employees. The employees filed for benefits and were determined eligible for the maximum benefits of $81.00 per week. During the month of February 1976 the company generally permitted most of the claimants twelve hours' work each week (with minor exceptions). Earnings for these claimants compared with UI benefits for each week in February were as follows:

Illustration 4.17
COMPARISON OF WEEKLY PART-TIME EARNINGS
WITH UI BENEFIT PAYMENTS--SELECTED EMPLOYER

	First Week			Second Week			Third Week			Fourth Week		
Claimant	Hours Worked	Earnings	Benefits	Hours Worked	Earnings	Benefits	Hours Worked	Earnings	Benefits	Hours Worked	Earnings	Benefits
A	12	$ 66	$ 81	12	$ 66	$ 81	12	$ 66	$ 81	12	$ 66	$ 81
B	12	66	81	12	66	81	--	--	--	12	66	81
C	12	66	81	12	66	81	12	66	81	12	66	81
D	12	66	81	12	66	81	12	66	81	12	66	81
E	5	27.5	81	8	44	81	12	66	81	12	66	81
F	12	70	81	12	70	81	12	71	81	12	71	81
G	12	66	81	12	66	81	12	66	81	12	66	81
H	12	66	81	12	66	81	12	66	81	12	66	81
I	12	66	81	12	66	81	12	66	81	12	66	81
J	12	69	81	12	69	81	12	69	81	8	46	81
K	12	70	81	12	70	81	12	70	81	12	70	81
L	12	70	81	12	70	81	12	71	81	--	--	-
M	12	70	81	--	--	--	12	70	81	--	-	-
N	12	66	81	12	66	81	12	66	81	12	66	81
O	12	66	81	12	66	81	12	66	81	12	66	81
P	12	66	81	12	66	81	12	66	81	12	66	81
Q	--	--	--	12	69	68	12	71	68	12	71	81
R	12	70	81	12	70	81	12	70	81	12	70	81
S	12	66	81	12	66	81	12	66	81	12	66	81
T	12	66	81	12	66	81	12	66	81	12	66	81
Totals	221	$1,238.5	$1,539	224	$1,254	$1,526	228	$1,284	$1,526	212	$1,190	$1,458

Source: Office of the Legislative Auditor compiled from division data.

Most of these claimants earned $66.00 per week and received $81.00 per week in benefits for a total income of $147.00 weekly. Another employer (another concrete company) was doing the same only on a smaller scale with ten employees. In this instance the claimants were qualified for the maximum of $81.00 and some with twelve hours' work were earning $106.00 for a total income of $187.00 weekly. The same pattern existed for the month of March and for other employers.

Obviously, some firms are taking advantage of the lenient Montana law allowing part-time earnings and the fact that payment of benefits to employees does not raise the employer taxes. As mentioned in Chapter III, page 74, there is no longer a charge-back to the employer's contribution account. Under the present payroll decline method of establishing employer experience rating, an employer's taxes are no higher if 20 part-time employees draw benefits or an equivalent payroll of six full-time employees and 14 totally unemployed claimants draw benefits. The procedure described above does not represent additional costs to the employers who abuse the part-time provisions and is rather generous to the claimants; however, it does result in an unnecessary cost and drain of the UI fund and penalizes other employers who have made contributions.

We also found that a number of claimants were working part-time on a continuous basis and drawing benefits. The following are examples of those instances.

--Clerk, bookkeeper--The claimant filed for UI benefits citing a temporary layoff and reduction to ten hours per week. The division determined the claimant eligible for $41.00 per week. Claimant received benefits for 50 weeks while working part-time earning up to $39.60 per week for 22 weeks. Then the claimant quit the part-time job because of a refusal to work on the weekend. Job search records showed that the claimant did not contact any potential employers during the first seven months of unemployment. After drawing 50 weeks, the claimant applied for a new claim year and was again determined eligible for $41.00 weekly based on wages earned during the part-time employment. The claimant received an additional 30 weeks of benefits. The claimant's job search efforts were

somewhat improved and the claimant now has a job. Benefits during 80 weeks totaled $3,280, while part-time earnings totaled $692.60.

--Bartender--Claimant filed for unemployment insurance benefits after being temporarily laid off due to a reduction of force. The division determined the claimant eligible for $63.00 per week. The claimant received 45 weeks benefits on this claim. About a year after opening the first claim the claimant filed a new one. The division again determined the claimant eligible for $63.00 per week, using nine months of part-time work as the qualifying wages. The claimant received 25 weeks of benefits under this claim, all the while working twelve hours part-time at $41.25 per week for a total income, including UI benefits, of $104.25 weekly. The claimant returned to full-time employment with the same employer who had provided the part-time work for 21 weeks at which time the claimant filed for a third claim year after being temporarily laid off. The division again determined the claimant eligible, this time for $67.00 weekly, again using the part-time wages as qualifying. The claimant now receives $60.00 per week Social Security pension income. Claimant's job search during this period generally was restricted to the employer who provided the part-time work and to the union hall. Benefits received during the period of 70 weeks totaled $4,410, while part-time earnings totaled $2,887.50.

--Bookkeeper--Claimant filed for unemployment benefits after being temporarily laid off. The division determined the claimant eligible for $66.00 per week. The claimant was working twelve hours per week earning $42.00 weekly from the employer who was responsible for the layoff. Total weekly income during the period was $108.00.

The claimant received 29 weeks of benefits and then returned to 40-hour workweeks for 14 weeks. The claimant then received another three weeks benefits at $66.00 plus part-time earnings from the regular employer. The claimant filed an application for a new claim year, and the division determined the claimant eligible for $72.00 weekly, partially on the basis of the part-time earnings. The claimant then drew 36 weeks of benefits while earning $60.00 per week part-time. The claimant was required to submit occasional job search records and generally indicated contact with only one other potential employer during the entire period of unemployment. There were no job referrals by the local office although a number of job openings were listed and filled. The claimant is again working full-time for the previous part-time employer. During this time the claimant received 68 weeks of benefits for a total of $4,704 while earning $3,522 as a part-time employee.

--Motel maid--Claimant filed for unemployment insurance benefits after being discharged for cause because of a refusal to work. The division determined the claimant eligible for benefits of $38.00 weekly after a four-week disqualification. The claimant received 30 weeks' of benefits. During this period the local office discussed several jobs with the claimant which were less than 40 hours per week. The claimant refused a referral for these jobs. The interviewer's comments were as follows: "Doesn't sound to me like she wants to work very bad. Had a definite 'No' ready before I even had a chance to explain each job." Claimant's job search consisted generally of contacting one motel in those weeks in which a job record was required. The division then determined the claimant

eligible for $26.00 per week on a new claim based on qualifying wages earned while working part-time. The claimant then received 33 weeks of benefits while working part-time. The job search records required during that period of employment show the claimant was not looking for a job--other than the part-time job she already held. After exhausting benefits, the claimant found a job for five hours a day. During the period benefits received for 63 weeks totaled $1,985 while part-time earnings totaled $803.39.

In addition to the repetitive part-time work while receiving benefits, there are many instances where occasional part-time work was found in our sample of claimants. Examples of occasional part-time workers earning fairly high amounts in relation to the weekly UI benefit are as follows:

Claimant	Allowable UI Benefit	Hours Worked	Earnings
A	$65.00	8	$75.00
	65.00	4	55.00
B	81.00	11	78.10
C	81.00	12	79.00

As can be observed from all of the cited examples, the provision of part-time work at twelve hours and sometimes less adds substantially to the weekly income of Montana Unemployment Insurance claimants. These circumstances suggest that both employers and claimants can abuse the provisions of the UI laws enabling part-time work and earnings while receiving UI benefits.

Montana's UI law (Section 87-149(a)(3), R.C.M. 1947) should be amended to eliminate the work disincentive caused by the twelve-hour provision and the payment of UI benefits to part-time workers who are not experiencing any significant measure of economic insecurity. As

mentioned on page 136, a dollar for dollar reduction of UI benefits for part-time earnings results in a work disincentive. On the other hand, too high an allowance for part-time earnings results in a wage subsidy program which of course is not what the UI program is intended to be. If it is desired to disregard a portion of earnings completely, and apply only additional earnings to benefit reduction, the disregarded amount should be kept small. If the disregarded amount is too large the benefit rate reduction would have to be greater than two-thirds to avoid a phase out point higher than 1½ times the weekly benefit amount. If this phase out point gets too much higher, the program would become a wage subsidy program. Accordingly, the amount of disregarded part-time income should be kept small to avoid a greater than two-thirds reduction of earnings and a possible resultant work disincentive. Such an amendment would effectively resolve those instances where employers are using the twelve-hour provision to the substantial benefit of their employees and to the detriment of the UI program.

RECOMMENDATION

We recommend that legislation be enacted to amend Section 87-149(a)(3), R.C.M. 1947, to eliminate the provision allowing the twelve hours and earnings twice the weekly benefit amount and provide for a partial unemployment provision allowing a sliding scale reduction for earnings at less than full employment.

RETIREES

The UI laws in Montana allow a retired worker to receive both retirement or pension pay and UI benefits provided he is otherwise qualified for UI benefits. Currently under Montana law, there is no

disqualification or reduction of UI benefits paid retirees unless the retiree's earnings or wage credits used to compute the UI benefit amount are from the same employer contributing to the pension payment (federal and Social Security excepted). Any retiree who returns to work and earns sufficient qualifying wages from another employer is eligible to draw benefits regardless of the pension amount received.

Section 87-106(g), R.C.M. 1947, provides that an individual shall be disqualified for benefits as follows:

* * *

> "Where retired and receiving retirement compensation paid in whole or in part from funds furnished by an employing unit, which when prorated on a weekly basis, exceeds two (2) times the average weekly benefit amount paid during the last fiscal year, such disqualification to be applied as follows: All wages earned by such individual in the employment from which he has been retired shall not be considered or included in determining his wage credits or weekly benefit amount under sections 87-103 and 87-105. This disqualification does not apply to retired federal personnel, and does not extend to the receipt of benefits under the Federal Social Security Act, as amended."

The above provision of law refers only to a disallowance of wage credits for computing the weekly benefit amount. There are no other Montana statutes which affect the granting of benefits to retired claimants.

Montana's current law regarding retirees and UI benefits is considerably different than when first enacted in 1937. Initially Social Security and similar federal payments were deducted from UI benefits. In 1953 the law was amended to its present disqualification form without the inclusion of excludable retirement pay. In 1955 the section was amended to exclude social security payments as currently exists. The exclusion of other retirement income was enacted in 1965 in the amount of $100.00; in 1973 in the amount equal to the weekly UI benefit, and in

1975 in an amount equal to two times the weekly UI benefit. The exclusion of federal retirement personnel was also enacted in 1975. Montana's law is one of the more lenient of the state laws. The laws of twelve states contain provisions requiring the deduction of Social Security pensions from the computed weekly UI benefit for which a retired worker is eligible. Two of these states, Iowa and Colorado, recently amended their laws to provide for a 50 percent deduction for Social Security pensions as contrasted to 100 percent. Further, the Oregon law provides for a deduction only in the week the Social Security pension is received. Thirteen states deduct payments of other employer pensions including federal and military pensions from the computed weekly UI benefit and an additional 21 states deduct the pension payment of a qualifying base period employer including federal and military (i.e., the pension is paid by the employer whose wage credits are used to determine eligibility and compute the weekly UI benefit). Eleven states have no disqualification or deductions for receipt of pensions whatsoever. Montana's law is unique and essentially represents no disqualification due to retirement pay. That is, the limitation set by law (two times the weekly UI benefit) is set sufficiently high so retirees are unaffected and federal retirees and Social Security benefits are specifically excluded.

The question of allowing retirees to draw UI benefits was recently addressed by the Congress in the Unemployment Compensation Amendment of 1976 (H.R. 10210). The legislation, which is not effective until October 1979, specifically provides:

* * *

> "(15) the amount of compensation payable to an individual for any week which begins after September 30, 1979, and which begins in a period with respect to which such individual is receiving a governmental or other pension,

> retirement or retired pay, annuity, or any other similar periodic payment which is based on the previous work of such individual shall be reduced (but not below zero) by an amount equal to the amount of such pension, retirement or retired pay, annuity, or other payment, which is reasonably attributable to such week; ..."

The new federal legislation requires that state unemployment insurance laws preclude payment of benefits to a retiree whose pension resulting from employment from whatever source exceeds the weekly benefit amount and provides for reduction of weekly benefits where the pension amount on a weekly proration does not exceed the weekly benefit amount. Interestingly, this change restores part of the original Montana provision requiring reduction of benefits equal to the social security payments.

The provisions contained in the above cited amendment are already in force in some states, i.e., dollar for dollar reduction of the weekly UI benefit for Social Security and other pensions. There is some speculation that the federal requirement for the preclusion of UI benefits to retirees will be amended by future Congressional action. Whether or not such an amendment will materialize is conjecture at this point. Montana's current UI law will not be in conformance with the new federal law unless either the federal law or the Montana law is changed.

During the 18-month period October 1, 1974 to March 31, 1976, the Employment Security Division paid $1,617,962 to 1,989 claimants who were receiving a retirement pension. In 1975 alone retirees received $1,089,689 in UI benefits This represents 2.9 percent of UI benefits paid that year.

Those 1,989 retiree-claimants who also received a pension were paid an average UI benefit of $54.20 per week for an average of 15.01 weeks.

During the 18-month period encompassed by our test 288 retiree-claimants were disqualified an average of 3.4 weeks because of voluntarily quitting, being discharged for cause or other issue unrelated to the receipt of a pension.

Using a statistical random sampling of 255 retiree-claimants, we found that the average weekly amount received for pensions was $52.39. Considering the type of pension, the sample showed average pensions received as follows:

Illustration 4.18
AVERAGE PENSIONS FOR RETIREES IN MONTANA

No.	Type of Pension	Amount
102	Social Security	$45.33
11	Social Security and Private	73.91
8	Private only	40.38
19	Government	84.21
104	Military	55.19
11	All other	23.64

Source: Compiled by Office of the Legislative Auditor from Employment Security Division files.

Instances of claimants drawing pensions and UI benefits simultaneously are illustrated by the following examples:

--Millwright--This claimant received his first unemployment insurance after a five-week disqualification for voluntarily quitting his job "to stay home." The claimant was almost 64 years of age and was drawing two pensions--private and social security--totaling $90.16 per week. Since the disqualifying period, the claimant has drawn 60 weeks of benefits at $68 per week and 33 weeks of benefits on a new claim at $53 per week. At October 9, 1976, he was still drawing benefits with seven weeks' eligibility left. The second

claim was supported by earnings before voluntarily quitting and earnings in subsequent quarters from a part-time job with his previous employer as a watchman one day per week. A recap of the claimant's weekly income while drawing unemployment benefits is as follows:

First Claim	Amount
Private pension	$28.98
Social Security	61.18
Part-time pay	34.32
Unemployment benefit	68.00
Weekly Total	$192.48
Second Claim	
Private pension	$ 29.98
Social Security	61.18
Part-time pay	39.76
Unemployment benefit	53.00
Weekly Total	$183.92

It should be noted that the claimant has not recently worked at the part-time job because the sawmill has since burned down and is being rebuilt. However, under Montana statutes, the claimant has worked enough part-time while drawing benefits to open yet another claim for another 20 weeks basic unemployment insurance, ten weeks federal-state extended benefits and ten weeks federal supplemental benefits for about $20 per week. The claimant was required to file job search records on ten occasions during the 22 months of unemployment, on which he indicated contact with his employer on each record and six other potential employers for any type of job.

During the 93 weeks, benefits totaled $5,829 and pension totaled $8,384.

--Governmental Budget Analyst--This claimant received his first unemployment insurance benefit check after being disqualified five weeks for voluntarily quitting. The claimant was 56 years old and retired from the U.S. government with a civil service pension. The reason given for quitting his job was retirement. The division made an initial determination of ineligibility due to a lack of demonstrated attachment to the labor market because the claimant made no definite contacts to find work and he limited availability to the type of work which he had voluntarily retired from. The claimant filed for a redetermination on the basis that he subsequently made contact with three local governments and two corporations and the division determined him eligible. A recap of weekly income is as follows:

Source of Income	Amount
Civil service pension	$200
Unemployment benefit	81
Weekly Total	$281

The benefits were computed on the basis of the U.S. government wage credits and were paid by direct reimbursement from the government. Job search records showed he had contacted 29 potential employers for a budget management job--obviously complying but searching for a non-existent job. The claimant is still unemployed. During the 47-week collection period, the claimant's benefits totaled $3,807 and pension totaled $9,400.

--Civil engineer--The claimant received his first unemployment insurance check after being permanently laid off. The claimant was 61 at date of filing and received a U.S. Civil Service pension. Based on wage credits earned with a private employer, the claimant was determined eligible for maximum benefits of $81 weekly. A recap of weekly income is as follows:

Source of Income	Amount
U.S. Civil Service Commission	$206
Unemployment Insurance Benefits	81
Weekly Total	$287

During the period unemployment benefits were received, the claimant was not referred to any job interviews, and we were advised by the manager that there were no such jobs in the area. The claimant's job search records show that contact with potential employers during the period was very limited--twice a month at the most--although the contact was not limited to engineering work. The claimant discontinued drawing benefits although he had eligibility for 13 weeks of federal supplemental benefits. His wife advised us that he is unemployed although looking for work and that he discontinued benefits because he didn't think it was right. The claimant's 39 weeks of benefits totaled $3,159 and his pension for that period totaled $8,034.

--Carpenter--Claimant drew his first unemployment insurance benefit check after being discharged because he was unable to perform at the pace required. The claimant indicated his age was 58 years and that he received a military pension equal to $189.75 weekly. The division determined him eligible for $57 weekly. After exhausting

that claim, the claimant refiled and was determined eligible for 26 weeks at $66 weekly. A recap of most recent weekly income is as follows:

Sources	Amount
Military pension	$189.75
Unemployment insurance benefit	66.00
Total	$255.75

The claimant was required to file job search efforts on two occasions and indicated five contacts for any type work. There were no job referrals by the local office. The claimant discontinued drawing benefits after receiving only two weeks at $66 per week because he got a job selling real estate. While collecting 48 weeks of unemployment insurance, benefits totaled $2,754 and pension totaled $9,108.

--Nurses aid--Claimant drew the first unemployment insurance check after taking leave of absence for eight months because of her husband's illness. The claimant is about 63 years old and receives Social Security. The division determined her eligible for $54 weekly. A recap of the weekly income is as follows:

Source of Income	Amount
Social Security pension	$ 54.75
Unemployment Insurance benefits	54.00
Total	$108.75

Six job search records indicated repetitive contacts with five potential employers including the former employer for work as either a nurses aid or a salesclerk (had spent 20 years as a nurses aid and some clerking in the 1930's). The former employer advised

that the claimant had applied for work but that she only wanted part-time work and specified hours which were unacceptable. The claimant collected 65 weeks of benefits totaling $3,510 while also receiving $3,558 in Social Security pension.

The above examples illustrate the effect of retirees drawing UI benefits while receiving several different types of pensions. While these retirees received UI benefits for a longer period than the average retiree-claimant, there are also retiree-claimants who received less UI benefits and who returned to work with shorter periods of unemployment. For example, three retirees drew benefits for only five weeks at $25 or less per week.

As previously mentioned, Montana's UI law with respect to retirees is currently different than the federal requirement which will take effect in October 1979. Unless the federal law is changed--a matter of conjecture and possibly unlikely inasmuch as it was just enacted--Montana will have to change its law or employers in Montana will lose the right to the federal UI tax credit.

Simply considered, claimants who are voluntarily or involuntarily retired are, in effect, removed from the work force. Those who voluntarily retire remove themselves from the work force and are, in essence, "voluntary quits" insofar as the UI program is concerned. Those who are involuntarily retired due to law, company policy, etc., are not "voluntary quits," but nonetheless are also removed from the work force as a condition of their previous job or employment. In any event, retirees who receive a pension or retirement pay from their previous employers are, in effect, still receiving pay or compensation as a result of their

previous employment. While they may be unemployed in a technical sense, they are not unemployed from a practical standpoint. They are retired.

The Montana law with respect to retirees and UI benefits needs to be changed, if for no other reason than to meet the eventual federal requirements. There is no sound basis for the present exclusion of Social Security and federal retirees--they should be treated no differently than other retirees. Retired employees should not be allowed to draw both retirement pay and UI benefits based upon preretirement employment with the same employer. If such employees intend to remain in the work force, they should be required to reestablish their eligibility for the UI program by meeting the statutory requirements for the program subsequent to their retirement. Such a requirement for all retirees would demonstrate the continued attachment to labor force and at the same time not penalize them for the years of previous employment. As previously mentioned, the federal law will require, after October 1979, that states preclude retirees from getting both retirement pay and UI benefits. A change in Montana's law to preclude retirees from being eligible for UI benefits until they reestablish their right to such benefits would not conflict with the new federal requirement. The state law would govern eligibility while the federal law would govern the payment of UI benefits, i.e., dollar for dollar offset of UI benefits for retirement pay.

RECOMMENDATION

We recommend that legislation be enacted amending Section 87-106(g), R.C.M. 1947, to:

1. *Preclude all retirees from receiving UI benefits based upon preretirement employment with the employer from whom they retired.*
2. *Require retired employees to reestablish their right to UI benefits subsequent to retirement by meeting the statutory work and earnings requirements.*

LABOR DISPUTES

Claimants involved in labor disputes receive unemployment insurance benefits under certain circumstances in Montana. Although not defined in law, a labor dispute is generally understood to be an economic controversy between management and labor involving collective bargaining, employee strikes and employer lockouts. Payment of benefits under these circumstances is not a routine process for the division as described in the previous sections and normally special attention is given to the propriety of such payments. There are three levels of decisions available to both the claimant and the employer: (1) a division deputy administrator for the initial decisions, (2) an appeal referee within the division functioning as the division Appeal Tribunal, and (3) the three-member Board of Labor Appeals. The appeal referee (Appeal Tribunal) is a state employee who is responsible directly to the division administrator. Sections 87-107 and 87-108, R.C.M. 1947, provide that the division appeal referee (Appeal Tribunal) is the first level of appeal for either the claimant or the employer. Each party to the appeal can be represented by an attorney at a hearing which is formal and intended to gather all pertinent facts and arrive at a conclusion based on the law. Appeals to the Board of Labor Appeals are conducted in much the

same manner, with all arguments and evidence formally presented and recorded. The Board of Labor Appeals consists of three members representing labor, business and the general public. Its decisions are binding on the division, employers, and claimants unless appeal is made to Montana district court.

The granting or denying of benefits involving a labor dispute is generally followed by appeals within these levels and sometimes into district court. Since 1972 there has generally been an increasing trend of appeals for labor dispute claims with 19 occurring in 1975. A sample of four instances where claimants involved in labor disputes were ruled eligible for benefits by the Board of Labor Appeals will be discussed in this section. These rulings have resulted in payment of benefits totaling $72,000 for one case, and a potential cost of $28,000 for two other cases which are pending appeal. There was no cost for a fourth because a Montana district court reversed the Board of Labor Appeals' decision awarding benefits.

Section 87-106, R.C.M. 1947, which was enacted in the original act in 1937 and has not changed in substance since, contains the criteria underlying the disqualifications for benefits in labor disputes. The section provides that:

"An individual shall be disqualified for benefits ...

(d) For any week with respect to which the division finds that his total unemployment is due to a stoppage of work which exists because of a labor dispute at the factory, establishment or other premises at which he is or was last employed, provided that this subsection shall not apply if it is shown to the satisfaction of the division that ...

(1) He is not participating in or financing or directly interested in the labor dispute which caused the stoppage of work; and

(2) He does not belong to a grade or class of workers of which immediately before the commencement of the stoppage, there were members employed at the premises at which the stoppage occurs, any of whom are participating in or financing or directly interested in the dispute; ...."

Benefits were paid to 118 employees of an oil company for a nine week period in early 1975. The total benefits paid amounted to $72,284. These employees were represented by a union in labor contract negotiations. The prior labor contract had expired January 7, 1975 and after failing to reach an agreement the union struck on January 18, 1975. The employer was able to continue production at the normal rate through use of supervisors and engineers, some from out-of-state refineries. Thus, no cessation of operations occurred at the refinery. A new contract was negotiated on April 14, 1975, and on that date the claimants returned to work.

The division awarded benefits to the claimants on the basis of the fact that there was no cessation of work at the establishment involved in the labor dispute. The key point in the award related to the statutory implication that a "stoppage of work" must exist to disqualify unemployed claimants. The award was appealed by the employer but it was upheld by both the division Appeal Tribunal and the Board of Labor Appeals. The employer has appealed the award to Montana district court; however the matter is still pending.

A decision awarding benefits to claimants who participated in the strike against a school system represents essentially the same situation as the oil company case. The school system hired substitute teachers to enable continuation of the classroom work. Again, no "stoppage of work" or cessation of operations occurred and accordingly, the division declared

the striking teachers eligible. To date, only eight teachers have received benefits for a total of $544; however, payment of one week's benefits to 382 additional claimants for a total of $25,976 is possible pending final appeal processes. The school district has appealed the decision; however the division Appeal Tribunal has not yet formulated its decision.

The third case observed involved a distinction between a strike and "involuntary unemployment" resulting from an employer lockout. In this instance two unions were negotiating as a team with the an employer association. After unsuccessful negotiations the employer made its final offer on March 1, 1972, issued an ultimatum that it must be accepted by March 5, 1972, or the plants would close the next day, March 6, 1972. One union voted not to accept and so notified the employer. The other union did not assemble for vote by the deadline but subsequently rejected the offer the following week. Members of the latter union reported to work March 6, 1972, but were not permitted to work because the plants had been closed as prescribed by the employers. On that date claimants from both unions filed for benefits. Bargaining was resumed later and the plants reopened on March 16, 1972, after negotiation of a settlement.

The division awarded benefits to the claimants on the basis that the claimants were involuntarily unemployed by a lockout. The division Appeal Tribunal reversed this decision on the basis of Section 87-106(d), R.C.M. 1947, concerning a work stoppage caused by a labor dispute and the fact that a lockout is a labor dispute. The Board of Labor Appeals reversed the Appeal Tribunal decision on the following basis:

1. The claimants whose names are attached to the decision of the appeals referee were deprived of the opportunity

to continue with their employment during the period involved by reason of the voluntary act upon the part of the association of employers in closing down the places of employment and that under circumstances the claimants do not come within the disqualification of the law particularly Section 87-106(d)(1)(2).

2. That said employees were at all times ready, willing, and able to work and willing to work at the various places of employment and were not in fact participating in, financing in or directly interested in the lockout which had been called by the employers whether it be described as a labor dispute or not.

3. The shutdown of operations on March 6 was a unilateral action by the employers and not a lockout. It constitutes involuntary unemployment of the 38 employees.

The employer has appealed the matter to Montana district court where it is still pending.

The fourth case concerns the employer association and members of a union. The union had negotiated unsuccessfully and chose to strike three of the seven members of the association on May 2, 1974. Stoppages of work occurred at those locations. On the following day, May 3, 1974, the other four members of the dealer association closed their shops in a lockout action until a new agreement could be negotiated. The locked out union members filed for unemployment insurance benefits.

The division denied benefits on the basis that total unemployment was caused by a "stoppage of work" due to a labor dispute. The claimants appealed the decision which was subsequently upheld by the division Appeal Tribunal. However, the Board of Labor Appeals reversed the decision and awarded benefits based on the following:

1. The Board finds substantial evidence that all of the employees of the four locked out establishments are entitled to benefits.

2. That said employees were working in 'separate establishments' as defined in Section 87-106(d)(2); the

four establishments having been engaged in a lockout as distinguished from a strike.

3. The Board also finds substantial evidence that of the employees of the four establishments that were not on strike but were encompassed within the bargaining group where so called lockouts existed were not participating in or financing in or directly interested in the lockouts at those particular premises or establishments.

The employer appealed the Board of Labor Appeals decision to the Montana district court. The state district court (Great Falls Employers Council v. Board of Labor Appeals, cause number 80369-A, Eighth Judicial District of Montana) reversed the board's decision and declared that the findings of fact by the Board of Labor Appeals were clearly erroneous and that there was no quantum of evidence in the record as a whole which would support the decision.

The foregoing instances are not all of the instances where claimants involved in labor disputes were paid benefits; however, these instances describe the trend that has occurred since 1972. The following illustration shows the 4½-year summary of appeal decisions involving labor disputes.

Illustration 4.19
MONTANA BOARD OF LABOR APPEALS DECISIONS INVOLVING LABOR DISPUTES

Calendar Year	Decisions			
	Reversed Claimant Eligible	Sustained Claimant Eligible	Sustained Claimant Ineligible	Total
1972	2	0	0	2
1973	0	0	0	0
1974	1	2	0	3
1975	12	1	6	19
1976*	3	0	2	5

*Through October, 1976.

Source: Office of Legislative Auditor compiled from division data.

The Comparison of State Unemployment Insurance Laws,[38] published by the U.S. Department of Labor, states that the state laws involving labor disputes do not question whether unemployment is incurred through the fault of the worker but rather intend to mark out an area that is excluded from coverage based on the premise that a neutral position must be maintained in labor disputes. This principle of neutrality is reflected in the fact that the disqualifications in the case of labor disputes are different than other disqualifications--they are a postponement of benefits as contrasted to a reduction or cancellation of benefits normally imposed for voluntary quits, misconduct discharges or refusal of suitable work. This neutrality is further reflected by other statutory provisions of Section 87-106, R.C.M. 1947, also enacted in 1937, which states that benefits shall not be denied to an otherwise eligible individual for refusing to accept new work under any of the following conditions:

> "(A) If position offered is vacant due directly to a strike, lockout, or other labor dispute;
>
> "(B) If the wages, hours, or other conditions of the work offered are substantially less favorable to the individual than those prevailing for similar work in the locality;
>
> "(C) If as a condition of being employed the individual would be required to join a company union or to resign from or refrain from joining any bona fide labor organization."

As previously noted, Montana law prohibits payment of benefits to an individual whose unemployment "is due to a stoppage of work which exists because of a labor dispute." What constitutes a "stoppage of work" has not been decided by the Montana Supreme Court. However, the Supreme Court in many other states have interpreted the phrase "stoppage of work." Some courts have held that "stoppage of work" means a total

cessation of operations by a plant on facility, while other courts have held that a "stoppage of work" refers only to the individual employees. Thus, if a plant or facility continues to operate with temporary help or supervisory personnel some states allow benefits to the strikers, while other states do not. 28 ALR 273, Section 13.

The Supreme Court of Oklahoma in Board of Review, et al., v. Mid-Continent Petroleum Corporation (141 P.2d 69 (1943)), interpreted Oklahoma's law, which is similar to Montana's, to mean that "stoppage of work" referenced the individual worker as contrasted to cessation of factory operations; that work ordinarily refers to or comprehends the activities of a workman; that one who is out on strike can hardly be said to be unemployed through no fault of his own, and that an employee on strike is not "available for work" so as to be eligible for benefits.

Another factor has recently been injected into the question of strikers eligibility for benefits. A recent ruling by the U.S. District Court, District of Hawaii, Hawaiian Telephone Co., et al., v. State of Hawaii Dept. of Labor and Industrial Relations, et al., 405 F.Supp. 275 (1975), held that a federal law, the National Labor Relations Act, preempts the payment of unemployment insurance benefits to claimants involved in a labor dispute. In this case, the court stated at page 290:

> "... Unless the state activity is but a peripheral concern of the act or there is an overriding state interest, a state may not assist either party in a labor dispute, i.e., interfere with free collective bargaining, a state must be neutral.
>
> "For a State to impinge on the area of labor combat designed to be free is quite as much an obstruction of Federal policy as if the State were to declare picketing free for purposes of or by methods which the federal Act prohibits. Garner v. Teamsters, 346 U.S. 485, 500 (1953)....

"On its face, therefore, Hawaii's statute irreconcilably intrudes into the federal process of free collective bargaining.

"It cannot with any validity be argued that Hawaii's law implements any necessary 'state purpose'. The striker picketing a closed-down shop is just as in need of benefits as is the striker picketing a shop in full operation. Nevertheless Hawaii now gives aid to the latter but none to the former.

"Congress has never even inferred that it approves this anomalous situation. In the absence of any Congressional approval, it can only be said that Hawaii's statute impermissibly intrudes into the area of labor law occupied by the N.L.R.A. The application of Hawaii's law also clearly frustrates Congress' case that the collective bargaining process must be free from state interference. Hawaii's statutory scheme for unemployment assistance to strikers therefore cannot stand, but must be stricken down."

The employer was granted a permanent injunction preventing the state from paying benefits to strikers. The Hawaii statutes regarding disqualification for labor disputes are almost identical to the Montana statute. The division has been paying benefits under the same apparent interpretation that Hawaii has applied--a stoppage of work or cessation of operations at the struck facility must occur to preclude payment.

The payment of benefits to claimants involved in a labor dispute is contrary to the intention of the Unemployment Compensation Act and appears to result because of differing interpretations of the law. Twelve states have amended their statutes to avoid the questions arising from the Montana statutes. Specifically Minnesota statutes, 1975 Supplement, Section 268.09, reads as follows:

"An individual shall be disqualified for benefits:

"(5) Labor dispute. If such individual has left or partially or totally lost his employment with an employer because of a strike or other labor dispute. Such disqualification shall prevail for each week during which such strike or other labor dispute is in progress at the establishment in which he is or was employed, except that such disqualification shall

be for one week following commencement of the strike or other labor dispute for any employee who is not participating in or directly interested in the labor dispute which caused such individual to leave or partially or totally lose such employment. Failure or refusal of an individual to accept and perform available and customary work in the establishment constitutes participation."

The preceding Minnesota statute appears to maintain the neutrality aspects of the disqualification for unemployment caused by direct interest in a labor dispute. Accordingly legislation should be enacted to clarify the ambiguities of the Montana statutes regarding the state's position of total neutrality in labor disputes.

RECOMMENDATION

We recommend that legislation be enacted to amend Section 87-106, R.C.M. 1947, to clarify the neutrality of the state in labor disputes.

LEGAL REPRESENTATION FOR THE BOARD

The attorney who represents the division also provides legal representation for the Board of Labor Appeals. This dual role presents a conflict of interest in every instance where the board decision is contrary to the division's interpretation of statutes and regulations. As a result, it prevents an aggressive defense of the division's position since the same attorney would be called upon to represent the board should the matter be appealed to district court. The decisions of the board are often contrary to the position taken by the division. Consequently, the attorney has maintained a position of neutrality because of the potential conflicting position before the court. This dual role precludes the division from appealing board decisions because the attorney

represents both the division and the board. In those instances where the board decision has significant implications contrary to the division's interpretation, it is important that the division maintain the integrity of the laws by appealing to district court. The division has not chosen to contest the board's decisions even though such decisions may disagree with the division's interpretation of the statutes. This is particularly important since the probability of the employer's contesting the decisions was substantially reduced when the new experience rating system was adopted--as discussed in Chapter III--the benefit payments no longer affect the experience rating and resultant tax rate. The division should resolve the situation by either employing a separate attorney for the board or requesting that the Attorney General provide the service in accordance with Section 87-146, R.C.M. 1947, and then appeal the board decisions when considered appropriate.

RECOMMENDATION

We recommend that the Department of Labor and Industry make appropriate arrangements to provide the Board of Labor Appeals with its own attorney.

Chapter V

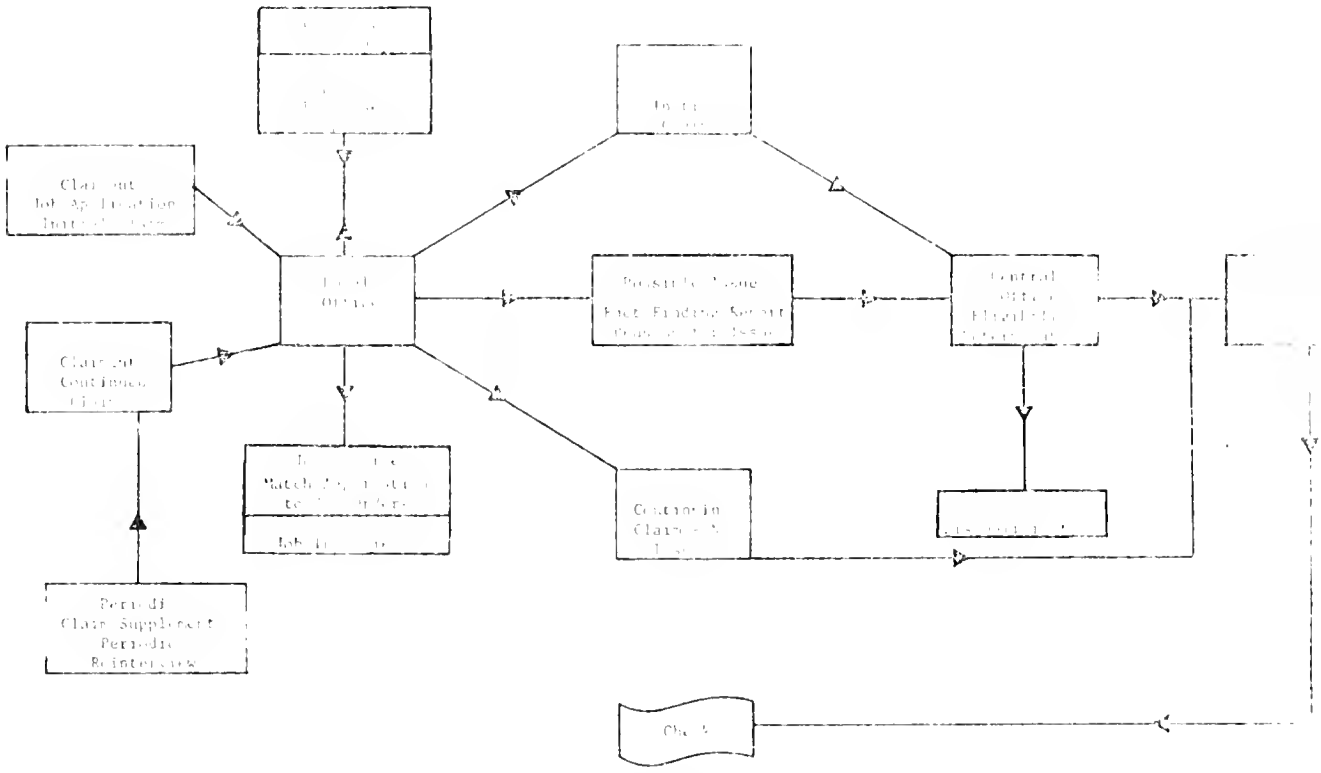
LOCAL OFFICE ELIGIBILITY DETERMINATION AND JOB SERVICE

THE ELIGIBILITY DETERMINATION PROCESS

The determination of whether unemployed workers are eligible to receive benefits is made by the central office in Helena. The initial determination made by the division concerns the nonmonetary aspects of eligibility such as the reason for separation from work and the monetary amount due the unemployed worker. Except for a limited delegation of authority to some local offices,,continuing or subsequent eligibility determinations are made on the basis of data obtained at the local office and transmitted to the central office. Chapter IV discussed the broad aspects of the initial determinations, both monetary and non-monetary. After the initial eligibility determinations are made, subsequent determinations are of a nonmonetary nature and relate to availability, seeking and refusal of work. Our principal interest in the subsequent determinations relates to placement of unemployed workers in jobs thereby removing them from the unemployment rolls. Obviously, an unemployed worker who is not available, not seeking, or refusing suitable work cannot become employed as easily as one that pursues a rigorous job search. Illustration 5.1 shows a simplified flow chart describing the eligibility determination process.

The purpose of local offices around the state is to provide a vehicle for submission of benefit claims, to provide a job service for locating jobs for unemployed workers and to provide acceptable employees to employers. The local offices have been staffed to meet these requirements through the establishment of claims processing and job placement procedures. In addition there are procedures established which the

Illustration 5.1
INITIAL AND CONTINUING ELIGIBILITY PROCESS
MONTANA EMPLOYMENT SECURITY DIVISION



Source: Office of the Legislative Auditor compiled from division data

local offices carry out to assure that unemployed workers are not obviously disqualified, are seriously seeking employment, are available for work, and that suitable employment is offered to unemployed workers. The data acquired by these procedures at the local office level are essentially intended to provide evidence of the unemployed worker's sincerity of attachment to the labor market. The importance of these procedures becomes evident when it is considered that the availability of unemployment benefits create greater unemployment by reducing the impact of remaining unemployed. That this fact exists has been established by several economic studies mentioned in Chapter IV.

It is not possible to measure the impact of each eligibility determination procedure on the probability of increased employment but as an aggregate the total process has a substantial impact. Essentially, the performance of the local offices is the initial and primary means available for verifying compliance with the laws which govern basic eligibility for the UI program. The impact of good or poor eligibility determinations is felt in two ways--first, the unemployed worker has an absolute requirement to seek employment with an objective of returning to work as soon as possible; second, other currently employed workers who may contemplate voluntarily quitting their jobs to collect unemployment will respond by retaining their currently held jobs in the face of a fair but stringent eligibility determination process. One study mentioned in Chapter IV concluded that doubling of the denial rate reduces unemployment by 1.4 percentage points, a very significant amount. Another study published by the Public Research Institute, A Model of Unemployment Insurance and the Work Test, supports the fact that unemployment is increased by lenient application of eligibility rules. The study stated in part, that "We found that the higher the proportion of claimants in a state who are denied benefits because they either quit their last job or failed the work test, the lower the unemployment rate."[39] The study also concluded that the higher UI benefits are, the less likely claimants are motivated to search for work while drawing benefits. The results of the study showed that a doubling of the denial rate would cause unemployment in white males to drop .44 percentage points with no other change in the UI system and that although the system does promote higher unemployment, the effect can be dramatically decreased by careful application of the work test--available for work and seeking work.

As a means of assessing the eligibility determination process in operation we visited nine local offices around the state. We selected these offices in a manner to represent large and small offices as well as urban and rural locations representing a cross section of the major industries in Montana. Our review at the nine local offices around the state disclosed that improvements could be made in the area of eligibility determinations.

Employer Confirmation of Separation

Upon an unemployed worker's initial contact with the local office to obtain benefits, the unemployed worker or "claimant" must prepare an "Initial Claim for Benefits and Request for Determination of Insured Status." A carbon copy of this form is routinely sent to the most recent employer for the purpose of verifying the claimant's statement as to why he is out of work. The results of this confirmation are important because the circumstances of separation may be grounds for an initial disqualification for either quitting, (i.e., voluntarily leaving without cause) or being fired for good reason, (i.e., a misconduct discharge). This document is the primary means of making such determinations.

Our random sample and review of recent claimants' files showed that there is a substantial breakdown of vital information at the initial stage. That is, there was only a 25 percent response from employers in answering the request to confirm separation data. In the absence of the employer statement, the local office generally makes no followup and proceeds on the assumption that the claimant's statement is correct. Accordingly the first step in eligibility determination--confirmation of the basis for unemployment--is not accomplished for 75 percent of the

claimants. While this weakness was disclosed by a sample process, there is reason to believe that the same weakness exists throughout the UI eligibility determination process.

Division officials express the view that the absence of an employer response may simply mean that the employer agrees with the reason cited by the claimant. While this is undoubtedly correct for many negative responses, there is probability that disqualifying separations are not being returned. This is because the current experience rating system has removed employer interest and incentive in responding to decrease charges against his contributions, i.e., the employer's individual tax rate is no longer affected by unemployment insurance benefit payments. One official in a local office advised us that prior to the change in Montana's experience rating system--where employee UI benefits are not charged to an employer--employer response ran as high as 80 to 90 percent. This is in contrast to the 25 percent disclosed by our sample.

Division officials said that benefits could not be withheld because employers do not respond that they were currently in the process of devising a "separation notice" which would be provided to all employers. Each claimant will be asked to provide the official "separation notice" whenever applying for benefits. They commented, however, that the failure to present the separation notice would not be cause for denial of benefits. A return to true experience rating as recommended on page 78 will encourage a higher response from employers. However, since the only meaningful data for making the initial determination besides the claimant's claim, is the employer statement, the division should institute measures to insure a response from employers. Until that recommendation is accomplished, which may take three years, the

division should devise a system of follow-up for non-responses. This follow-up should emphasize the importance of the employer response in making the initial eligibility determination and that interim benefit payments will be used to develop the employer tax rate when experience rating becomes effective. The fact that time constraints exist for issuing the claimant's first benefit check does not negate the value of follow-up--the data provided by such a process could be used for a later disqualification as deemed appropriate.

RECOMMENDATION

We recommend that the division institute follow-up measures necessary to insure that employers provide information needed by the division to determine eligibility.

Job Search and Availability

The determination of whether the claimant is available and seeking employment is a matter of continuing scrutiny by the local office. Generally, greater emphasis is intended to be focused on claimants who do not show serious attachment to the labor market--really do not want to work--in contrast to those who have a strong attachment--really want a job. For this reason local offices are instructed to make a determination of this attachment and so label claimants either "A" or "C" as follows:

"A"--strong attachment to the labor market--temporary layoff, steady job holder, etc.

"C"--Weaker attachment to labor market.

The determination is judgmental on the part of claimstakers but is intended to trigger a more intensive processing for "C" claimants. One

substantial difference under current procedures employed by the division, is that "A" claimants are reinterviewed only every ten weeks as contrasted to every one to five weeks or sooner for a "C" claimants. A review of local office files selected randomly shows that 44 percent of the claimants are not classified as either "A" or "C" and consequently a large number are never reinterviewed. Thus the continuing eligibility process has begun to weaken before it starts simply because an established procedure is not being followed.

The next process is to establish the claimant's sincerity and efforts of independent job search and availability for employment. This is done primarily through two procedures used by the local offices. The first is sending a claim supplement to the claimant at selected intervals--normally when a program is exhausted. This form seeks to establish the claimant's job search effort by requiring him to list three employers contacted in the previous week for possible employment. The claim supplement also checks the claimant's availability by questioning the claimant's available transportation, child care problems (if any), health, and education plans. If the data reveals the claimant is not making an independent job search effort or is restricting his availability in some manner, then an issue or question of disqualification from further UI benefits may be developed and sent into Helena for determination.

Many of the claim supplements show an inadequate job search. Some of these are illustrated by examples presented in Chapter IV. Even in those numerous occasions when the claim supplement showed that the claimant had not contacted a single potential employer we found no evidence of disqualification issues being raised. The local offices as

a general rule are not raising disqualification issues where job search has been inadequate.

Further, we found that there was no attempt by the local offices to verify whether the claimants are actually contacting the employers whom they say they have contacted. It would appear that random checking to verify contact and a notation on the claim supplement of this possibility would be a worthwhile measure to encourage job search.

The requirement for an active job search is inherent in the basic eligibility determination prescribed by Section 87-105(c), R.C.M. 1947, i.e., a claimant must be ready, willing, able, and seeking employment. During our review we contacted a random sample of claimants to ascertain the success of job search in relation to how often the claimant had searched. The response of 226 claimants shows that claimants who found a job were generally more active in their job search than those who did not find jobs. Interestingly, we found that 20.5 percent indicated only an occasional job search as contrasted to daily and weekly. It would appear that whatever incentive the local offices can extend to require more aggressive job searches would be worthwhile in placing claimants.

The second major procedure for determining that claimants are available and seeking work is the periodic reinterview process. Current requirements of the Division are that a claimant should be reinterviewed every five to ten weeks depending on the designation "A" or "C". Examination of claimant files at the local offices shows that only 22 percent contained a record of reinterview. The reinterview process is designed to verify the claimant's job search and availability for work.

We found that the Billings local office had conducted a survey to determine the value of the reinterviewing process. The survey covering

100 claimants, resulted in disqualification issues being raised on about 40 percent for failing to report for the periodic reinterview, not seeking work, not available for work, not able to work, and refusal of job referrals. Continuation of the intensive reinterview process by the Billings office obtained even more startling results than the first test. A total of 1,507 reinterviews were conducted with disqualification issues being raised on 782 claimants or 52 percent. These issues resulted because the interview showed 466 claimants were either not available, not seeking, or refused work. The other 316 issues were "no shows," for the reinterview process. Failure to report for reinterviews is cause for discontinuing payments. The Billings local office manager advised that the analysis of 1,507 reinterviews was correct but was biased by the fact that it included first time school employees who were disqualified because of their refusal of suitable work and obvious intention to return to their old jobs. He said the initial survey and results were probably more valid than the second. Nevertheless, the second survey corroborated the results of the first survey and both illustrate the effect of the reinterview process.

The accomplishment of reinterviews in an intensive fashion would be a worthwhile endeavor in the continuing eligibility process. The Public Research Institute publication Unemployment Insurance and Eligibility Enforcement indicates that a 10 percent increase in staff time for eligibility determination will cause a 5.8 percent increase in all denials and 10.4 percent increase in the work test denials (requirement that claimants seek jobs).[40]

The results of our examination at the local offices show that the local offices have not been effective in pinpointing issues which underlie

eligibility determination efforts. The division has on two very recent occasions attempted to increase the eligibility effectiveness. On March 26, 1976 and June 7, 1976 the division sent letters to local offices encouraging the periodic reinterviews. However, the guidelines currently used by the local offices as guidance for the raising of issues (ESD Montana Operations Manual, Section 540) are not adequate. They do not emphasize the importance of the job search process and address the fact that inadequate job search is a basis for raising a disqualification issue.

The apparent weaknesses in the eligibility determination process discussed above are important because their existence adversely affects the whole eligibility process. The eligibility determinations made in Helena rely entirely upon the initial and recurring information provided by the local offices. In other words, assurance that UI benefits are paid only to those who are ready, able, and willing to work, depends upon the local offices. The division considers the issues raised by the local offices and in the past has disqualified 85 percent of the claimants where the local office has questioned continuing eligibility. If local offices fail to raise issues the entire process is weak.

Part of the failure at the local offices may seem from the "crunch" in processing claims--local office officials indicate that claim processing takes priority over both the pinpointing of eligibility issues and job placement. It is obvious that increased job search caused by more stringent enforcement of the various requirements for eligibility would substantially reduce unemployment and the disbursement from the UI trust fund. Thus it would appear that additional efforts by local offices and additional supervision from the division is warranted even at additional cost.

RECOMMENDATION

We recommend that the division take measures to strengthen the unemployed workers' job search process by:

1. *Requiring local offices to:*
   - A. *Classify unemployed workers as prescribed to enable a more intensive focus on those most unlikely to seek employment.*
   - B. *Require claim supplements at more frequent intervals to enforce a more aggressive job search for unemployed workers.*
   - C *Perform random checks of the indicated potential employer contact to verify the job search.*
   - D. *Intensify the periodic reinterview process as accomplished by the Billings local office for the specific purpose of determining continuing eligibility.*
   - E. *Submit disqualification issues to the central office whenever the unemployed worker fails to meet predetermined standards for availability, job search, or refusal of suitable work.*
2. *Revise current guidelines provided to local offices to emphasize the importance of the job search requirement.*
3. *Revise the claim supplement and reinterview forms to indicate possibility of checking with the potential employer and potential disqualification if job search is inadequate.*
4. *Intensify field supervision of local offices to obtain the desired disqualification issue identification.*

JOB SERVICE

The local offices provide job service or placement service in conjunction with the provisions of UI benefit claim service. The job service function essentially complements that of the insurance function in that both are intended to resolve economic insecurity caused by loss of jobs. A system of occupational codes used to categorize claimants assists in matching job openings to unemployed workers.

When positions become available from a local employer, the local office prepares a "job order" which lists information concerning the employer, the particular job and corresponding requirements. The local offices categorize the job orders into occupational codes to enable eventual matching to applicants. As the new job order becomes available, the active work application file is periodically reviewed to determine if qualified individuals are actively seeking similar employment. If the applicant meets the employer's specifications, he is referred to the employer for a job interview. Each unemployed worker referred for interview receives an introduction referral card which assures the potential employer that the applicant has been properly screened.

Additional Occupational Codes

As mentioned above, the occupational code is a key to matching applicants to job openings. The job application contains provisions for primary and additional occupational codes thus broadening the applicant's chances of job placement. The "primary" occupational code is often the occupation in which the individual previously worked to establish wage credits for his UI benefit claim. The additional occupational codes include those occupations of past work history or even those of particular

interest to the applicant. Each applicant can list six occupational codes--three on the job application card and three on an "additional application."

The applicant would then be referred to openings in any of the six areas of work. The listing of additional occupational codes in this manner enables broader exposure to job openings and greater opportunity for placement than the individual who is categorized with only one occupational code.

Our random sample of job applications in various local offices indicated that only one occupational code was used for 96 percent of all applicants. We did not find any instances where the "additional application" was used. The use of more than single occupational codes has definite application in Montana. Our random survey of claimants indicates that 81 percent are willing to accept jobs in other than their regular line of work. A large percentage of claimants in our survey also indicated that they actually changed occupations when jobs were obtained.

The reason for the limited use of additional occupational codes appears to be two-fold. First, the local office is charged with the responsibility of job referral and search on behalf of the claimant during the benefit period. While receiving benefits, the claimant must be actively seeking employment at least in that area where he earned his wage credits. A claimant who refuses a position in the occupation in which wage credits were earned can be disqualified from benefits. For this reason personnel pay particular attention to the primary occupational code.

Second, further emphasis is placed upon the use of only one occupational code because of the mechanization of claimant records. Computer

input forms filled out by the local office (sent to the Helena central office) have only one space for an individual's occupational code. The Deputy Administrator for Employment Services confirmed that usually only one code is utilized per individual and attributed this limitation to the fact that the computer currently accepts only one code per applicant. In addition, he advised that more than one occupational code per person might create problems with statistical record keeping--an individual with two codes would appear as two available applicants seeking employment instead of one.

The use of more than a single occupational code has potential for earlier placement of job applicants obviously because applicants could be matched to a greater number of job openings. The division should revise the computer programs to avoid the statistical record problem and permit the matching of additional occupational codes for each applicant.

RECOMMENDATION

We recommend that the division implement procedures to require the use of additional occupational codes for qualified applicants.

Displaying Local Job Openings

Local job orders were not posted on the "Job Information Bulletin Board" in seven of the nine local offices we visited. These local office managers expressed the concern that individuals might discern the employer from a job order and contact the employer without the job screening and referral provided by job service. However, we found that in those offices where job orders were posted for public viewing, the posted information identified the employer only by a code number and described the position and qualifications required. Office managers at

these two locations reported that the posting of local job orders was successful with applicants and that it saves interviewer time because applicants provide "self-screening."

An applicant who feels qualified for a position must contact the receptionist for an interview. The interviewer will then review the job order, and the applicant's qualifications to determine whether a job referral should be made. The applicant does not learn the employer's name unless the interviewer believes he has qualifications sufficient to meet the employer's needs.

One additional benefit of a system of job posting is apparent--applicants not categorized by occupational codes for a particular position would not normally be matched to the job order. With physical access to the local job opening, the applicant can provide this matching function and perhaps secure employment outside of his regular occupation.

Unemployed workers should be given the opportunity to change occupations, particularly if they are qualified. On the other hand, the need for adequate applicant screening and job service referral is obvious. Employers who use the job service office do not want a large number of unqualified applicants wasting their time. However, the posting of local job orders without disclosure of the employer's name presents very definite advantages for those searching for employment. The local offices use various news media for advertising job openings with success. Such posting at the local offices is merely an extension of advertising and is no more detrimental than radio or newspaper advertising.

RECOMMENDATION

We recommend that the division require local offices to display job orders without disclosure of the employer name.

Job Match Process

Positions which the local offices find hard to fill can be circulated statewide by processing an inter-area order to the central office in Helena. Helena then forwards information by mail concerning the position to all job service offices throughout the state. Any local office may then match their active work applications with the hard to fill position. A qualified applicant who is interested in the position is then put in contact with the local office representing the employer. Conversely, individual applicants may also have their personal records distributed statewide. An applicant who is willing to relocate and has "professional" or "skilled" qualifications can fill out a "Professional Application." This application is forwarded to the Helena central office which prepares a brief biography and work history. This information is then distributed by mail to all local job service offices throughout the state. One additional avenue is open to the job applicant. An individual willing to relocate to a particular city can have his qualifications forwarded to that particular job service office without statewide clearing. The designated local office will conduct a job search on his behalf. The local offices will not use statewide clearing for local positions that they expect to fill with local job applicants--only the "hard to fill" positions receive statewide attention.

We randomly selected 22 "hard to fill" positions that were posted in two job service offices. The openings were in seven different cities throughout Montana. We contacted the originating local offices to determine the status of the positions for each of these openings. Six of the positions had already been filled. One of these was still on a local office bulletin board but had been filled 36 days prior. Another

had been filled 24 days prior to when it was observed on the bulletin board. In another instance we found two job orders in different cities to have the same job order number.

In each of the local job service offices, we learned that not all of the job orders are cleared statewide. It was also determined that only an individual with "professional" or "skilled" qualifications receives statewide exposure via job service. Local office managers expressed the view that they would not need to clear the unskilled worker to all local offices since this type of worker would generally not be inclined to change residence to secure employment. However, our random survey of claimants showed that 37 percent were willing to change locations for a job. Further, there was a greater percent of claimants finding jobs that were willing to move than there were who would not move.

All job openings and all applicant qualifications are not available to all local job service offices. In addition, the information that is made available to all offices is not always current and it is an entirely manual operation. Coordination of a network of labor market information and job referrals should be performed by the Helena central office. An adequate system of job referral must be based upon timely information. The need for effective job match process presents a unique opportunity for the division. On one hand, there are numerous people (claimants) seeking jobs while on the other hand there are job openings (job orders) around the state. Due to the manner in which the division characterizes both job applicants and job openings in terms of numerical occupational codes, the elements of a ready-made data base are available. These factors, combined with the high volume and high turnover of data (jobs

and applicants) and the fact that successful job placement averts or reduces the need for subsequent UI claims and benefits, would seem to be reason enough for the division to undertake the establishment of a more sophisticated and aggressive job bank system. The division should explore the feasibility of applying modern data processing techniques to the job bank function. In this regard, there are data processing equipment and techniques which would facilitate and expedite the handling, storage, and retrieval of information and data about job applicants and job openings. Data processing services currently in use by other state agencies such as remote terminals, visual display terminals, and other such equipment tied directly into the state data processing center would allow direct input, compilation, comparison, search and output of job related information by the various elements within the division including some of the local offices. In this regard, the state has the data processing capability to perform this function.

Inasmuch as virtually all other states are faced with the same high volume job applicant-job opening matching problems faced by the division other states may have already designed and implemented an automated job bank system. The division should ascertain whether any other state has accomplished this and irrespective of the outcome, determine the feasibility of such a system in Montana. Division officials advised that they are aware of the need for an effective job match system. They advised us that the U.S. Department of Labor has encouraged Montana to develop an automated job bank system as a part of a nationwide process. However, they have resisted because they believe the costs are substantially less under a manual system. They further stated that they are continuing to seek a computerized system which is within cost reason. In this regard,

they advised us that Montana is currently the only state without a computerized job bank system. An automated job bank system would comprise a large part of a job match process--the other part being data on unemployed workers.

RECOMMENDATION

We recommend that the division continue to study the feasibility of a fully automated job match system in Montana.

FOOTNOTES

1/ William Haber and Merrill G. Murray, Unemployment Insurance in the American Economy (Homewood: Richard D. Irwin Inc., 1966), pp. 61-64.

2/ Ibid., pp. 61-64.

3/ Ibid., pp. 65-69.

4/ Ibid., p. 70.

5/ Ibid., pp. 70-75.

6/ Hearings Before the Subcommittee on Unemployment Compensation of the Committee on Ways and Means, U.S. House of Representatives, 94th Congress, April 8, 1975, p. 1.

7/ "Unemployment Insurance, Part I, Programs and Procedures," Monthly Labor Review, Oct. 1975, p. 11.

8/ Ibid., p. 11.

9/ Montana Operations Manual (Helena's Montana Employment Security Division, 1956), part 142.01.

10/ Ibid., part 142.02.

11/ Ibid., part 142.04.

12/ Paul J. Smith, "Benefit Adequacy," Manpower, August 1975, p. 6.

13/ Julius Shiskin, "Employment and Unemployment: The Doughnut or the Hole?" Monthly Labor Review, February 1976, p. 7.

14/ Martin Feldstein, Unemployment Policy After the Recession," presented at the Lehran Institute's Economic Round Table, October 16, 1975.

17/ Haber, Op. Cit., p. 381.

18/ Ibid., p. 380.

19/ Frank Brechling, Unemployment Insurance Taxes and Labor Turnover: Summary of Theoretical Findings (Arlington: Public Research Institute, 1975), p. 9.

20/ Joseph Becker, Experience Rating in Unemployment Insurance: An Experiment in Competitive Socialism(Baltimore: Johns Hopkins University Press, 1972), pp. 177-209.

21/ Christopher John, An Evaluation of Proposed Alternatives for Increasing UI Tax Revenues (Arlington: Public Research Institute, 1975), pp. 6-7.

FOOTNOTES (Continued)

22/ Eugene C. McKean, The Taxable Wage Base in Unemployment Financing (Kalamazoo: Upjohn Institute for Employment Research, 1965), p. 92.

23/ Becker, Op. Cit., p. 1.

24/ Ibid., p. 17.

25/ Report of the Committee on Employer Experience Rating (Washington: Interstate Conference of Employment Security Agencies, 1940), p. 34.

26/ Comparison of State Unemployment Insurance Laws (Washington: U.S. Department of Labor, 1975), pp. 2-5 through 2-7.

27/ Becker, Op. Cit., pp. 369-370.

28/ Brechling, Op. Cit., p. 7.

29/ Comparison of State Unemployment Insurance Laws, Op. Cit., p. 3-1.

30/ Gene Chapin, "Unemployment Insurance, Job Search and the Demand for Leisure," Western Economics Journal, March 1971.

31/ Kathleen Classen, The Effect of Unemployment Insurance: Evidence from Pennsylvania (Arlington: Public Research Institute, 1974), p. 32.

32/ Arlene Holen and Stanley A. Horowitz, "The Effect of Unemployment Insurance and Eligibility Enforcement on Unemployment," The Journal of Law and Economics, Oct. 1974, p. 425.

33/ Comparison of State Unemployment Insurance Laws, Op. Cit., p. 4-5.

34/ Martin Feldstein, "The Economics of the New Unemployment," The Public Interest, Fall 1973, pp. 33-34.

35/ Merrill G. Murray, The Treatment of Seasonal Unemployment Under Unemployment Insurance (Kalamazoo: Upjohn Institute, 1972), p. 38.

36/ Ibid., pp. 74-76.

37/ Strengthening Unemployment Insurance (Kalamazoo: Upjohn Institute, 1975), p. 33.

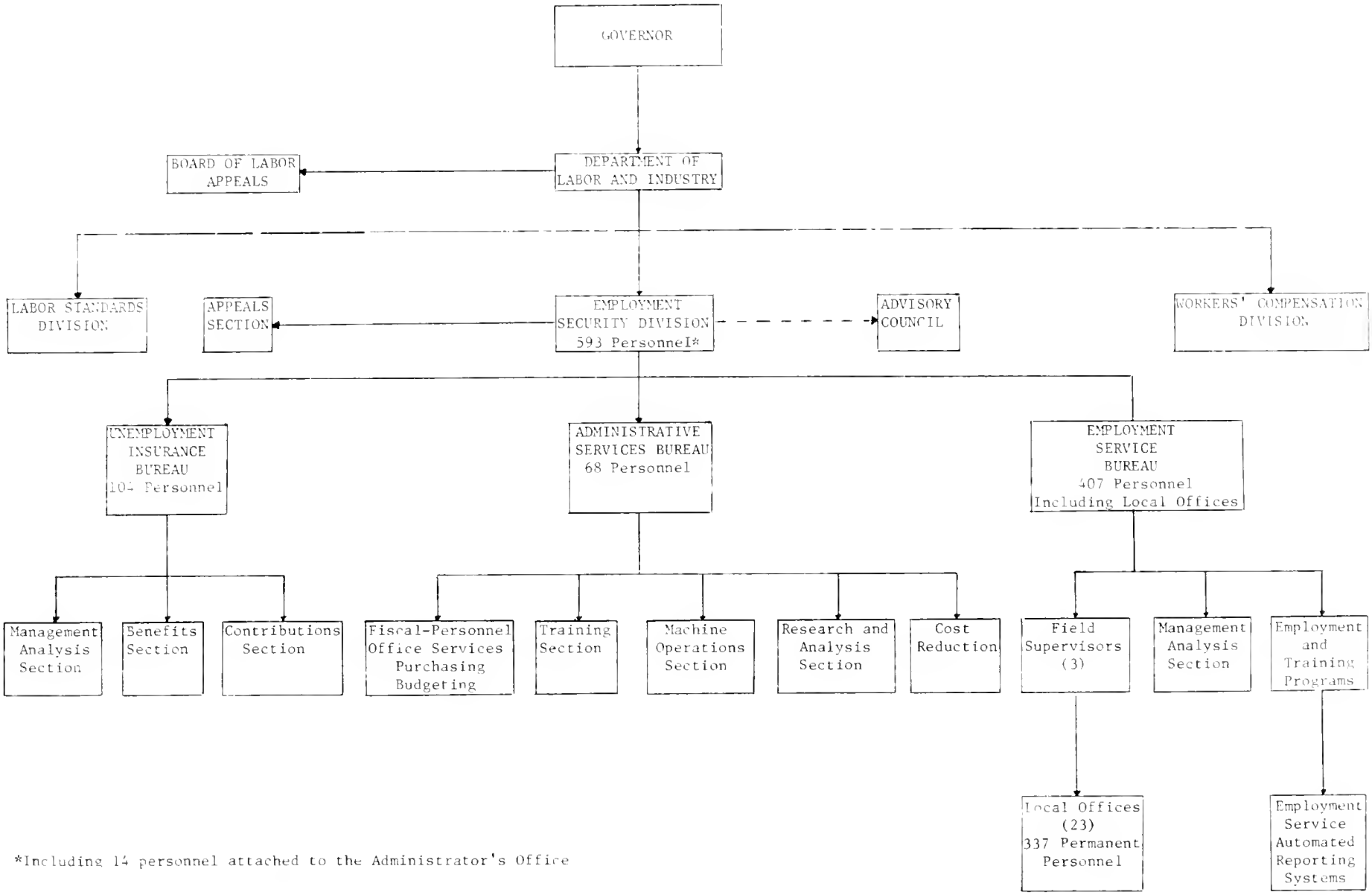
38/ Comparison of State Unemployment Insurance Laws, Op. Cit., p. 4-10.

39/ Stanley Horowitz, A Model of Unemployment Insurance and the Work Test, (Arlington: Public Research Institute, 1975), p. 1.

40/ Stanley Horowitz and Arlene Holen, Unemployment Insurance and Eligibility Enforcement (Arlington: Public Research Institute, 1975), p. 8.

APPENDICES

EMPLOYMENT SECURITY DIVISION ORGANIZATION CHART



*Including 14 personnel attached to the Administrator's Office

REPORT ON
THE UNEMPLOYMENT COMPENSATION ACCOUNT
ADMINISTERED BY
THE EMPLOYMENT SECURITY DIVISION
MONTANA DEPARTMENT OF LABOR AND INDUSTRY

NOV 2 1
MONTANA LEGISLATIVE AUDITOR

November 2, 1976

HENDRICKSON & BIRD, INC.

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1212 Helena Avenue
Helena, Montana 59601
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November 2, 1976

Mr. Morris L. Brusett
Legislative Auditor
Capitol Building
Helena, Montana 59601

Dear Mr. Brusett:

Pursuant to your request, we have enclosed our report on the Unemployment Compensation Account of the Employment Security Division. The comments and recommendations stated herein were based on information obtained from the office of the Legislative Auditor, as well as from other sources, as deemed necessary.

Respectfully submitted,

Alton P. Hendrickson

Alton P. Hendrickson, ASA

mac
Enclosure

NOV 2

MON. DEA LEGISLATIVE AUDITOR

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INTRODUCTION

The Unemployment Compensation Account is a fund established under the Unemployment Compensation Laws to provide for the payment of unemployment benefits in Montana.

The financing of this account is accomplished through compulsory employer contributions based on the rate structure established by the Montana legislature. The rate structure provides for automatic increases which are triggered when the account reserves decrease below prescribed levels. The intent of the rate structure is not only to provide income sufficient to pay the unemployment benefits on a regular basis, but also to accumulate sufficient reserves to allow payment of benefits during extended periods of high unemployment.

The purpose of our study was to determine what services, if any, could be provided by an independent actuary to the Employment Security Division in maintaining its Unemployment Compensation Account. The study was based upon information provided by the Montana State Office of the Legislative Auditor, the United States Department of Labor, and several actuarial reports on unemployment insurance funds. A summary of our findings and recommendations is contained in this report.

ROLE OF AN INDEPENDENT ACTUARY

In years past it was uncommon for individual states to retain the services of independent actuaries. The states looked to the Department of Labor to provide the necessary guidelines, and financial assistance in the event the funds became insolvent. The Department of Labor uses the services of actuaries and, in fact, in the 1950's it employed independent actuarial services in reviewing the funds of the various states to make recommendations as to their adequacy.

The increasing number of state funds becoming insolvent appears to have encouraged the use of services of independent actuaries. At this time, six states retain independent actuaries on a regular basis. Other states have used actuaries on occasion for such purposes as determining the rate structure and designing computer programs for projecting adequacy of the funds.

An actuary provides services to unemployment insurance funds in the following areas:

1) To determine a reserve level which would be adequate to absorb the additional costs during periods of high unemployment.

2) To establish a rate structure which would provide uniform contributions adequate to meet the normal unemployment benefit requirements, as well as to assist in building the required reserve.

3) To adjust the rate structure to reflect benefit changes in order to assure that each generation of employers bears its fair share of the unemployment insurance costs.

4) To prepare annual reports giving his opinion as to the adequacy of the fund and comments and recommendations for legislative action.

MEASURES OF ADEQUACY

The reserves in the Unemployment Compensation Account grew steadily from inception in 1938 to their peak in 1956 of $46,184,000. At this time the account was more than adequate by any standard to meet its obligations in providing unemployment benefits. High unemployment was experienced in Montana during the late 1950's resulting in a decline in the Unemployment Compensation Account from 1957 to 1966, at which time it began to grow until 1970. Since 1970 the fund has steadily decreased from $25,903,000 until reaching insolvency in March of 1976.

One of the most important goals of an unemployment insurance fund is to build sufficient reserves to allow for the fluctuation of unemployment benefits which occur from year to year. The purposes of adequate reserves are three-fold:

1) It allows an employer to reasonably project and budget for costs in funding the unemployment program.

2) It minimizes the economically undesireable situation of increasing the employer's rates during a time of recession.

3) It eliminates a need for the tax structure to respond immediately to cyclical changes in the unemployment level.

Many attempts have been made to determine the reserve level necessary to deem a fund adequate. Because of the difficulty of determining the scope of future unemployment, adequacy tests are based upon past experience. The most commonly accepted measure is that recommended by the 1959 Benefit Financing Committee of the Interstate Conference of the Employment Security agencies. This measure is obtained by dividing the reserve ratio (the fund balance divided by total wages) by the highest cost rate (benefits paid in a given year divided by total wages during that year) in the preceding 10 years. The committee determined that the fund is reasonably adequate if this ratio is between 1.5 and 3.0, with a preferable minimum of 2.0.

This test is based on two assumptions:

1) Cyclical periods of economic decline will occur at least once in every seven years. Therefore, using the highest cost in a ten year period should include a period of high unemployment.

2) Periods of recession last from 18 to 36 months (1.5 to 3 years). Therefore, using a multiple of 1.5 to 3 should provide adequate security.

Using this test at the lower level of 1.5, Montana's Unemployment Compensation Account was inadequate during the period 1962 through 1971. The fund met this minimum adequacy test during 1972 and 1973.

The Employment Security Division has applied the above adequacy test with one deviation. The Division applied the highest cost over a period in excess of 10 years. On this basis, the Division determined that its fund was insufficient each year since 1962.

COMMENTS

During its 39 year history, the Unemployment Compensation Account has experienced severe fluctuations. Because of the cyclical nature of unemployment rates, fluctuations are to be expected. However, it is our opinion that the account fluctuations should not have been as severe as they were.

The account was adequately funded after its first ten years of existence and the rates could have been reduced at that time, recognizing the possible need for increases in the future. Because of the overfunding, a nationwide study in the 1950's determined that the benefits in Montana could be increased without a resulting increase in the contribution rates. This financial situation may have created a false sense of security, while unemployment benefits continued to increase.

Through 1956 the contributions were consistently higher than the benefits paid. Since that date, the benefits have generally exceeded the contributions. The main reason for this reversal was that the average weekly wage upon which benefits were based increased while the wage base upon which contributions were made remained constant until 1971. It was then increased from $3,000 to $4,200. It is our opinion that this situation should have been and could have been recognized years earlier. The result would have been a recommended increase in the taxable wage base, resulting in an overall increase in contributions.

While the application of actuarial techniques would have disclosed the precarious financial position of the account unrecognized by the Employment Security Division, consideration must be given to several facts:

1) The purpose of the reserve is to fund benefits when the costs exceed income. Therefore, it is not intended that the reserve meet "adequacy" tests at all times, rather just during times of normalcy. As such, it was not expected that the fund be adequate immediately following the high unemployment during 1958-62.

2) Further, it is recognized that the depleted reserve can not be replenished in one year. Unfortunately, no guidelines appear to have been given to the Division as to the date the reserve should have once again been adequate. Inasmuch as the reserve began growing after 1964, the Division may not have felt any reason for concern as to the solvency of the fund.

   Since high unemployment cycles are expected every seven years, it is important that the fund be replenished within this period. Had the rate been set high enough to replenish the fund in the seven year period, it appears that the fund would not have become insolvent.

One of our major concerns is the lack of documentation regarding the solvency of the fund. It is our opinion that a report on the financial soundness of the fund is of utmost importance. Such a report would review the gains and losses of the fund during the last year and would demonstrate the strength or weakness of the fund in light of various measurements available. This information would be extremely valuable to the legislators when making fiscal decisions.

While testing the adequacy of the fund is important, we feel that even more important is the establishment of a proper rate structure. This would encompass many factors including the taxable wage base, the rate of contribution, adjustments for experience rating, emergency rate increases when necessary, etc. If the rate structure were properly reviewed and implemented, the fund would necessarily be adequate. Measurements could be applied to the fund from time to time check the reasonableness of the rates as established.

RECOMMENDATIONS

We feel that the total rate structure of the unemployment insurance account should be carefully reviewed. Inasmuchas the fund is now insolvent, the rate structure should be set up in such a manner as to adequately provide for unemployment benefits as they arise in the future, repay the federal government for the funds which have been borrowed, and replenish the reserve over a relatively short period. In restructuring the rates, the following points should be considered:

1) It is our opinion that the present taxable wage base is too low. It is presently set at $4,200 which is moved to $4,800 for emergency funding. The federal government is requiring that the taxable wage level be moved up to at least $6,000 by 1978. Ideally the taxable wage level should be equal to the average weekly wage upon which unemployment benefits are determined. Increasing the taxable wage base would provide equity in that employers paying higher wages would bear a larger share of the cost since unemployment attributable to such employers costs more than unemployment attributable to employers paying lower wages.

   It has been argued that low wage earners commonly receive more unemployment insurance benefits. Studies have shown that this assumption is not necessarily true. Further, high unemployment with any given employer should be reflected through experience rating rather than through presumptuous formulas.

2) The triggering mechanisms in times of emergencies should be more responsive to the drain of the funds. Presently no additional funding occurs until the fund drops below 2.5% of total compensation. We would recommend that this percentage be increased.

3) The present experience rating system does not adequately respond to unemployment with any particular employer. We feel that the experience rating system should be reviewed carefully and revised.

As noted earlier the present measurements for adequacy of reserves is inappropriate. We feel that such rule of thumb measurements should be available to test adequacy of the reserves at any given point. However we feel that the measurement should be revised and approved. The present measurements assume high unemployment is cyclical within ten or fewer years. This has not proven to be the case and we feel that this particular measurement should be extended over a longer period. Possibly all years of experience should be used with the highest five years of cost being averaged.

Computer programs can be used effectively in determining the financial requirements of the unemployment insurance fund. While computers cannot predict unemployment rates in the future, they can be used to determine the adequacy of the present financial structure under certain unemployment conditions in the future. With this type of prediction mechanism, it is possible to determine not only the adequacy of the fund but also at what point it will become insolvent under conditions of extreme unemployment. We would recommend that consideration be given to the possibility of purchasing soft-ware computer programs which have already been developed and specifically designed for unemployment insurance funds.

We recommend that an annual report be compiled each year which provides more than statistical data regarding the unemployment insurance fund. This report should provide commentary as to the adequacy of the fund and if necessary provide recommendations as to steps which would prevent the fund's eventual insolvency or excessive reserves.

AGENCY REPLY

attention should serve to emphasize its importance and endorse the agency's efforts and the need already expressed by the Governor, for implementation of a computerized job bank in Montana.

The total information compiled in this single source will be most helpful to legislators, and is, by far, the most comprehensive study on Montana Unemployment Compensation Law attempted to date.

Rather than respond to the Legislative Auditor on specific proposed legislative changes, the Employment Security Division will make its legislative recommendations to the Governor, after consultation and discussion with the Employment Security Division Advisory Council.

Sincerely,

Fred Barrett

FRED BARRETT, Administrator
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